CURRENCY AFTER THE WAR

The British and American Plans

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CURRENCY AFTER THE WAR

THE BRITISH AND AMERICAN PLANS

PREFACE

On the day of the publication of the British Plan for an International Clearing Union, a journalist asked a member of the Government what he thought of it. The Minister replied: "Who am I to comment on my Lord Keynes?" The view that the Keynes Plan is a matter for currency experts only was shared by the majority of the public. While the Beveridge Plan seized the imagination of many millions of people, the interest aroused by the Keynes Plan remained largely confined to a small number of specialists in monetary questions. In Parliament the Leader of the House of Commons refused to allot more than one day for the debate on the Plan, on the ground that there was not sufficient demand on the part of the M.P.s for more time. The Beveridge Plan was given three days; yet the question whether or not it will be possible to adopt the Beveridge Plan will depend to a very large degree on the solution of the currency problem after the war

If as a result of linking the pound to the dollar too rigidly, and removing exchange restrictions that would facilitate the task of maintaining it at its rigid parity, deflationary methods should be re-introduced, then there could be no question of "freedom from want" For this reason, the post-war currency problem is the concern of every man, woman and child, not merely of a small circle of specialists. The main cause of the world's economic difficulties between the two wars was that the public, instead of taking an intelligent interest in monetary policy, left it to the experts who could only view it through the narrow spectacles of their specialised knowledge. Let us hope this mistake will not be repeated this time. As a matter of fact, during recent years the general public has taken an increasing interest in monetary problems Its interest has been largely confined, however, to the internal aspects of money; its international aspects, with which the Keynes Plan is concerned, are still neglected. While there is a growing public opinion in favour of an expansionist internal monetary policy, there is no public opinion about the system of foreign exchange to be adopted after the war, beyond a vague feeling that sterling must not be linked again to gold

The reason for the lack of interest in the Keynes Plan on the part of laymen—including those sitting in Westminster—is the assumption that it is too technical for anybody but the expert to understand. As a matter of fact, there is nothing in the Plan that could not be grasped by anybody of average intelligence The present book is an attempt to discuss the principles and details of that Plan, together with those of the American Plan for an International Stabilisation Fund, in as non-technical a language as possible, to enable the man in the street to form an opinion on the problems involved.

While on the whole I am strongly in favour of the Keynes Plan, I am fully alive to its shortcomings. Under its terms the degree of the elasticity of sterling appears to be inadequate. It also carries the danger of its interpretation in an unduly orthodox spirit This danger is very real. There is a tendency to regard the Plan as a means of returning to unplanned Free Trade such as existed in totally different conditions before the last war and, to a less extent, also between the two wars. Should the Plan be used for this purpose it would rule out the possibilities of planning in the internal economic sphere. And substantial as the benefits are that the world could derive from the Plan, they disappear in significance compared with the benefits obtainable from economic planning. I shall try to show, however, that the Keynes Plan could be used in a way that would help internal planning instead of hindering it.

A large part of the book is devoted to a comparison between the British and American Plans. This comparison is based on the original terms of the two Plans as they were published in April, 1943. Such information as will be available when this book goes to press about subsequent modifications of the two Plans will be dealt with summarily in a Postscript

The American Plan in its present form lays itself open to much criticism not only because the facilities it proposes are inadequate but also because even these inadequate facilities are offered in return for relinquishing the right to devalue sterling and other currencies without the consent of the United States, for undertaking to offer to the proposed international institution any gold Great Britain and other countries may add to their depleted stocks after the war, and for relaxing exchange restrictions to a degree that would rule out an expansionist monetary policy In the circumstances those who maintain that, while the Keynes Plan is the better of the two, even the American Plan is better than no Plan are entirely wrong The American Plan, unless modified to a large extent, would not help but hinder reconstruction in Great Britain, and would deprive Europe of the chance of achieving prosperity with the aid of economic planning and monetary expansion

This does not mean that the American Plan has nothing in its favour. It contains some good points which would deserve to be incorporated into the Keynes Plan. There are a number of other points on which the British Treasury could afford to make concessions for the sake of an international agreement. On the other hand, there are many points on which it could not yield without sacrificing vital British and European interests.

Taking a long view, American interests would also be better served by a Plan which, while representing a compromise between the British and American Plans, would be decidedly nearer to the former. I should like to emphasise that although this book examines the post-war currency plan primarily from a British point of view, it is not inspired by economic nationalism, and is certainly not directed against legitimate American interests The British point of view happens to be identical with the general interests of the progress of mankind, progress which is bound to confer benefits on debtor and creditor nations alike. Unfortunately, it seeems unlikely that the Washington Administration, Congress and American opinion will realise this fact. In all probability the United States Treasury will remain opposed to the incorporation of the essential features of the Keynes Plan into any scheme in which it is prepared to participate. If the negotiations should break down there is at least a possibility for the adoption of the Keynes Plan for the Sterling Bloc, including Continental countries. It is to be feared, however, that for the sake of concluding an international agreement with the participation of the United States, Great Britain might be prepared to accept the essential points of the American Plan. In that case the Keynes Plan would be shelved. It would be idle to deny that the chances of an early adoption of the Keynes Plan are none too bright.

Nevertheless, the principles embodied in the Keynes Plan indicate beyond doubt the system of the future, the adoption of which is a mere question of time. It is inconceivable that mankind should put up very much longer with the irrational system of uncontrolled international transfers International exchange clearing between Central Banks enjoying a monopoly of exchange dealing in their respective countries is the rational system and is bound to come. And sooner or later the immense advantages of a system under which international credit facilities can be expanded in accordance with requirements are bound to be realised.

P. E.

130, QUEEN'S GATE,
LONDON, S W 7, *August*, 1943.

CHAPTER I

INTRODUCTORY

BEYOND doubt the realisation that the monetary system is not an end in itself but merely a means towards the end of progress and prosperity ranks among the most important landmarks in the evolution of mankind. It may enable us to reduce the role of money to that of a servant instead of submitting to its rule as hitherto It has opened immense possibilities for the progress of human welfare, far beyond the most optimistic dreams of previous generations living in the deep darkness of monetary orthodoxy. Even in our own lifetime, not so many years ago, it was generally considered a matter of course that the welfare of nations should be sacrificed for the sake of upholding man-made monetary rules as if they were immutable laws of nature. Between the two wars, 1½ millions of able-bodied workmen in Great Britain were condemned to more or less permanent idleness for the sake of "enabling the pound to look the dollar in the face." Despite the crying need for goods, capacity to produce them was left partly unused in all countries because it would have been contrary to the classical monetary doctrines to create the credit required for financing full production. This conception has now been challenged by the modern school of thought which believes that producing capacity and the requirements of the public should determine production, and that financial resources needed for the purposes of production and consumption must be made available.

It may seem difficult to understand why mankind willingly put up for so long with the tyranny of the orthodox monetary system, and why an immense amount of human happiness was so readily sacrificed in order to uphold rules which could have been changed with a stroke of the pen The answer is that it was not by sheer accident that the change in the monetary conception occurred during recent years and not earlier. The teachings of the monetary reformers responsible for the change would have fallen on barren soil before the last war, when the working of the orthodox monetary system was generally considered satisfactory, or even between the two wars when, nothwithstanding the immense difficulties, it was hoped against hope that it might be possible to patch up the old system somehow. What is perhaps even more important, the adoption of the new system would have been premature before the necessity for a high degree of economic discipline had been realised.

The question whether new world trends create the great men responsible for them, or whether it is the accidental birth of such great men that brings about the changes has been the subject of endless controversy amongst historians. The truth probably lies somewhere between the two conceptions, though infinitely nearer to the former than to the latter. Had Lord Keynes lived some centuries ago he would probably have been burnt at the stake for his heresies Had he lived a few more centuries earlier he might have been able to achieve the acceptance of his doctrines which happen to fit in with the then prevailing system of Guilds. Had he lived in the nineteenth century, smug self-satisfaction over the then existing system of *laissez-faire* would have ruled out any possibility of his proposals being considered seriously It is a piece of remarkably good fortune that he should have arrived on the scene just when the crying need for a change had come to be realised under the pressure of events, and especially when mankind had become receptive to the idea of economic discipline without which Lord Keynes's monetary reforms would be doomed to failure.

On the other hand, it is doubtful whether without Lord Keynes it would have been possible to make official opinion, expert opinion and public opinion realise that the orthodox monetary laws are not sacrosanct and can be changed at will. In itself the realisation of the disadvantages of a system is not sufficient, so long as the conception prevails that the system is unalterable, and that mankind is fated to put up with these disadvantages as it is fated to put up with amospheric disturbances over which it has no control. There were manv others besides Lord Keynes who advocated monetary reform between the two wars. Most of these pioneers were people whose enthusiasm outran their knowledge of the subject, in plain English they were currency cranks. For any trained economist it was child's play to pick holes in their immature doctrines. These reformers, or at any rate many of them, had the right ideas. What they lacked, however, was the background of a thorough knowledge of the orthodox system which they sought to overthrow. Yet it is essential first to absorb orthodoxy before departing from it. In order to reduce the citadel of monetary orthodoxy, defended as it was by the formidable authority of generations of economists and by an intimidating array of bankers and other specialists, together with the force of tradition, it was necessary that the defenders should be assailed with their own weapon That weapon was provided by Lord Keynes when he placed himself at the spearhead of the attack. It was thanks to his intervention that progress has at last achieved a decisive victory over monetary traditionalism. It was he—together with Mr. Reginald McKenna, the most progressive of bankers—who provided a scientific background and a *cachet* of respectability for the new movement which would otherwise have remained a subject of mild amusement and superior sneers to the initiated, and might never have achieved any positive results.

It was in the internal monetary sphere that the first battle was fought and won. Some time before the War the automatic system was abandoned in favour of a managed system, even though this management was inspired by considerations of immediate expediency rather than by any scientific considerations. What mattered above all was to defeat the conception of monetary scarcity and obtain the acceptance of the conception that money must be made available for financing production to the limit of productive capacity. It was during the war that this conception was adopted, no merely as a matter of expediency, for financing arms production, but as a principle to remain in force after the war.

The second main battle of the campaign is, however, yet to be fought, this time in the international sphere. It is all the more difficult since the possibility of applying monetary expansionism outside the borders of particular countries is not realised by the public or even by most experts. While the shortcomings of the existing international monetary system were only too painfully evident, the existence of an alternative was unknown until the publication of the Keynes Plan. Even now very few people realise that the substance of that Plan is the international application of the doctrine of monetary expansionism

Until now it was assumed that the power of money to check expansion remained supreme and unchallenged in the international field, and that the capacity of the nations to buy foreign goods essential for their welfare was necessarily limited by the amount of foreign exchange they received for their exports plus the proceeds of international loans. The Keynes Plan has made it evident, however, that mankind can overcome the limitations of international means of payment. It shows the way in which money can be created for sound international requirements, in a similar way as it can be created for sound internal requirements. The difference is that while the will of a single Government is sufficient for the creation of money for internal purposes, the combined will and co-operation of a number of Governments is necessary to make it possible to create money for international purposes.

There is one thing common to internal and international monetary expansion; both call for a high degree of economic discipline Whenever internal expansion was attempted in the past without at the same time enforcing an adequate degree of economic discipline, the result was advanced inflation with all its destructive consequences. Notwithstanding this, very few people are aware of the necessity of enforcing economic discipline in order to be able to expand money with impunity. Most expansionists imagine that all that is necessary is to turn on the tap of currency and mankind will live happily for ever after. When it comes to international expansion the necessity of combining it with discipline in the sphere of international trade and finance does not appear to have been realised even by the authors of the British Plan. This is indicated by the contradictions in the Plan's attitude towards exchange restrictions, and even more bv the absence of any provisions for planning international trade to be expanded under the scheme There is no evidence that even Lord Keynes himself has realised that unplanned international expansion is liable to produce results as disastrous as unplanned internal expansion. When in May, 1943, Sir Kingsley Wood opened the Debate in the House of Commons on the Keynes Plan, a number of subsequent speakers complimented him on his " Free Trade speech " Evidently the Keynes Plan is regarded by most people, including its authors, as a means for reverting to free trade, that is, to unplanned world trade This is a dangerous conception, and one of the main objects of this book is to draw attention to the fact that unless the danger is realised, the Keynes Plan might well prove to be the thin end of the wedge, making for a return of orthodoxy. For the sake of its unquestionable advantages many people, including, perhaps Lord Keynes himself, might be inclined to accept Free Trade, which they would otherwise have opposed. The resulting anarchy in international trade would be liable to upset internal planning In the absence of internal planning, internal monetary expansion would be certain to lead to disaster, to avoid which the Government would resort to deflation. The misuse of the most progressive monetary measure of all times would thus result in a return to narrow " scarcity economics."

Nothwithstanding this danger, the Keynes Plan is to be welcomed, provided that it is supplemented by safeguards against its misuse for creating anarchy in world trade. Whether international trade is to be planned by a central international authority or through a number of bilateral trade agreements is open to argument. The continued existence of bilateral trade agreements would not be incompatible with the Keynes Plan. In the absence of some such plan, bilateral agreements would have to be concluded under the pressure of the foreign exchange position of the parties concerned, and their principal aim would be to solve the foreign exchange problem involved. Thanks to the Keynes Plan, it would be possible to negotiate bilateral agreements guided solely by the fundamental economic interests of the contracting parties. It would also be possible to secure a higher degree of elasticity of bilateral trade. Details of this argument will be worked out in the subsequent chapters. For the present purpose it is sufficient to re-emphasise that the planning of foreign trade is as essential to the success of the Keynes Plan as the planning of home trade is to the success of internal monetary expansion. Needless to say, if, instead of a number of bilateral trade pacts it were possible to conclude some international plan for world trade, it would be so much the better But even if in the absence of some such agreement trade would have to be planned by means of bilateral pacts, it would be infinitely preferable to sacrificing internal economic planning by exposing it to the shocks produced by the incalculable fluctuations of unplanned Free Trade.

The absence of any indication in the Keynes Plan or in subsequent statements that this aspect of the problem is duly realised is not the only cause for fears that the Plan might lead to developments contrary to the spirit in which it is conceived. The possibility that economic and monetary orthodoxy, having been barred at the front door, might be assisted by the Plan to sneak in by the back door cannot be ruled out. In addition to the temptation of sliding back into the anarchy of unplanned Free Trade for the sake of the advantages of the Keynes Plan, there is also the temptation of accepting for their sake an unduly rigid system of stability of the exchanges. It is true Lord Keynes assured the House of Lords that nobody could be more anxious than he to avoid the rigid stabilisation of sterling to the dollar. Nevertheless, it is impossible to overlook the fact that under his Plan a majority decision of the Board of the Clearing Union would be in a position to prevent an adjustment of sterling, however fully justified by the situation, for at least twelve months From this point of view, too, approval of the Keynes Plan must be subject to the provision of safeguards against reverting to monetary orthodoxy That the possibility is widely envisaged is indicated by the fact that on the announcement of the terms of the Keynes Plan, there was a marked setback in the gilt-edged market, on the assumption that under that Plan it would be necessary to defend the stability of sterling by means of high interest rates and other deflationary methods. Should such a situation arise it would of course rule out the possibility of increased economic planning and of planned monetary expansion.

Neither the dangers that the Keynes Plan might lead to unplanned trade, nor that it might lead to deflation, have been adequately emphasised by most critics of the Plan. On the other hand, the alleged dangers of allowing gold to retain an undue power in the monetary and economic system have been grossly over-emphasised. There is a superstitious fear abroad about the sinister power of gold, and while its past record fully justifies caution, the fears that under the Keynes Plan the gold standard would be restored are entirely unfounded. Gold would play a limited part in the Plan, and the participants would be entirely at liberty to determine their attitude towards gold. Indeed, one of the great merits of the Plan is that it has devised a formula under which it will be possible to overcome the quantitive limitations of gold. And since the main objection to the monetary role of gold is that it leads to "scarcity economics," the Keynes Plan has certainly provided the formula for a "gold standard without tears."

Another major advantage of the scheme is that it tends to balance foreign trade by bringing pressure to bear on both deficit countries and surplus countries to aim at equilibrium In this respect the Plan may not have gone far enough to satisfy most of us, but it made a good start in an entirely new direction with considerable possibilities.

Admittedly, the Keynes Plan has its limitations, and its authors show themselves well aware that it is not a universal remedy against all diseases of the international economic system. It would break down under the strain of a major disequilibrium. It must not be used on too ambitious a scale, at any rate in the beginning If an attempt were made to finance reconstruction through the system, the limits fixed for the "overdrafts" of the nations would soon be reached. The system is only suitable for covering temporary and normal requirements of current trade. For major capital transfers, separate institutions are proposed.

The Plan leaves a free hand to the participants to determine their national monetary systems, whether they are in favour of the stability of currencies in relation to gold or against it, and whether they want to retain exchange restrictions or would like to restore the free foreign exchange market. This was inevitable in order that the scheme should stand a chance to be acceptable to the United States. It would have been of little practical value to elaborate a theoretically ideal plan under which gold would be dethroned altogether and under which exchange restrictions would be compulsory. Considering that the United States holds the bulk of the world's gold, and Mr. Cordell Hull is strongly opposed to exchange restrictions, any such scheme would have been rejected out of hand by the Washington Treasury.

Will the Keynes Plan be acceptable to the United States as a result of the concessions embodied in it to meet the American point of view? Simultaneously with its publication, an American plan, drafted by Mr. Harry D. White, was published by the United States Treasury. The Allied Governments will have to decide how much of each Plan to adopt. The differences between them are by no means irreconcilable. But it would serve no purpose to underrate them The American plan is a "rich man's plan," not only because it advocates the removal of exchange restrictions, but also because in the proposed Stabilization Fund the member Governments would have to begin with a substantial deposit, while under the British "poor man's plan" they can begin with an overdraft. The American plan is well thought out in detail, and some of its features are preferable to the British plan. It lacks, however, the broad conception of the Keynes Plan, its profound philosophy. It is a product of painstaking, practical thinking rather than of imagination and of genius. While the Keynes Plan is said to be ahead of the times, the White Plan is criticised for being behind the times For this very reason, however, the two might complete each other remarkably well.

The subsequent chapters will attempt to give a detailed analysis of both plans, to ascertain their points of similarity and their discrepancies, and to suggest a way of striking a fair and acceptable compromise between them Before embarking on that task, it will be necessary to indicate the defects of the pre-war system in order to show the necessity for a radical change.

There is rather more than a possibility that the negotiations pursued at the time of writing will end in a deadlock.

It is the duty of the Governments concerned to do their best to avoid such a deadlock. But it would be self-deception to rule it out as impossible. For this reason the alternative to the conclusion of an international agreement on the lines of the Keynes and White Plans has to be dealt with in this book. Some adherents of the international solution seem to be under the impression that the way to serve their cause is to paint the consequences of a breakdown of negotiations with the darkest possible colours. In doing so, they hope to frighten Treasuries, Parliaments and world opinion into striking a compromise just as some old-fashioned people are frightened into being reasonably good by the threat of hell-fire In reality, while the international solution would greatly assist progress, its absence would not necessarily mean the advent of the three capital " C's "—Crisis, Chaos and Collapse There would be the alternative of reverting to currency blocs with multilateral trade within them and bilateral trade between them.

It is to be hoped that the Treasury will not sacrifice vital British interests for the sake of concluding some international agreement with the participation of the United States. Essential as close collaboration is between the two Anglo-Saxon Empires, there is a limit beyond which it would cease to be worth while to make one-sided sacrifices for the sake of achieving such collaboration. Public opinion must realise this, and must make itself felt in order to prevent the Government from sacrificing progress and prosperity in the interests of an international currency scheme which would be bound to fail sooner or later. What would be the use of discarding one fetish only to replace it by another? No currency scheme is wanted for its own sake, only for the sake of the results it can produce in the form of increased production and consumption. It is from this point of view, and from this point of view alone, that the merits of any suggested compromise between the Keynes Plan and the White Plan must be judged.

CHAPTER II

FOREIGN EXCHANGE BEFORE THE WAR

THE study of the pre-war system of foreign exchange is a fascinating subject to anyone capable of taking a human view of it. This may appear difficult to most experts and laymen alike because on the face of it foreign exchange appears to be the most inhuman branch of an apparently inhuman science. Yet there is a great deal of romance, tragedy and comedy in the history of foreign exchange. Even during the prosperity and stability of the nineteenth century there are some interesting episodes though, generally speaking, in foreign exchange like in everything else happy nations have no history.

The really thrilling period began with the foreign exchange difficulties brought about by the last war. To the future student of economic history the collapse of the mark, the ups and downs of the franc or the fall and subsequent recovery of the pound, will read like so many thrilling adventures. Speculators who attacked various currencies from time to time between the two wars will be looked upon in the same way as our generation looks upon the pirates and robber-barons of centuries gone by We can afford to regard these malefactors as romantic heroes even though their contemporary victims must have felt otherwise about them In the same way, the generations brought up amidst a rational economic system may see the romantic side of the struggle between the authorities trying to maintain order and stability in foreign exchange and the hosts of speculators trying to upset that stability. They may be unable to see the sordid realities in the activities of these modern pirates and bandits. The tragedy of the collapse of a currency, the comedy of a successful bear squeeze in the foreign exchange market, and many thrilling episodes in the history of the foreign exchanges between the two wars will appeal to them all the more since their own experience will be devoid of any such excitement. The task of modern statesmanship is, however, not to provide exciting reading-matter for the entertainment of future students of history but to seek to bring nearer a rational era.

It is a commonplace of economic literature to describe the nineteenth century (which for the present purpose ended in 1914) as an ideal period from the point of view of foreign exchange. Indeed, the system of *laissez faire* appeared to operate satisfactorily Most currencies which had been on the gold standard had remained stable, and the extent of such fluctuations as occurred occasionally in some of the weaker currencies was moderate. Even wars failed to produce major foreign exchange upheavals The depreciation of the French franc for instance, following on the lost war of 1870-71 was negligible and purely temporary, in spite of the heavy reparations imposed on France by victorious Germany. The margin of profit on speculation in foreign exchange was in most cases very narrow and consequently speculation was confined to a relatively small number of specialised professional dealers. From the point of view of international trade, the system worked very satisfactorily. There was no need for exchange restrictions even in the financially weaker countries because they were able to secure long-term loans to cover their trade deficits. Even though Russian Grand Dukes and others were in the habit of keeping a reserve in London in case of trouble at home, generally speaking, flights of capital were non-existent. The absurd situation in which poor countries involuntarily " lent " vast sums to rich countries did not arise until after the last war The entire system of foreign exchange operated for the benefit of those for whom it was meant to operate: importers and exporters in the broadest sense of the term.

It is customary to attribute this satisfactory state of affairs to the working of the gold standard In reality, those who believe this mistake the effect for the cause It was not because the gold standard was in operation that the system worked satisfactorily. On the contrary, it was because of the stability of the underlying conditions that the gold standard was able to operate. It is of the utmost importance to realise this fact in order to avoid wishful thinking about the possibility of a return to the nineteenth century system after the war. Many people seem to imagine that this can be done if we want to do it In reality, the possibility of operating the orthodox system before 1914 was due to a series of circumstances—political, economic, and financial—which no longer exist.

1. After the Napoleonic wars there were no major wars during the 19th century comparable with the wars of 1914 and 1939 Such wars as occurred from time to time did not spell wholesale ruin among entire populations of the countries involved. For this reason the flight of capital caused by war scares was relatively moderate. It could be counteracted in most cases by putting up interest rates to a level at which the war risk appeared to be offset by the higher yield thus offered

2. Although revolutions occurred from time to time during the 19th century, fear of revolutions was not sufficiently strong to give rise to wholesale emigration of capital.

3 Socialism was a minority movement in every country before 1914. The control of Governments by the wealthy classes appeared to be unchallenged and there was no need to fear anti-Capitalist legislation.

4. Direct taxation was moderate in every country in so far as it existed at all. Flight of capital from taxation was practically unknown.

5. The price levels in various countries were reasonably stable and were at approximate equilibrium with each other. Changes in the price levels were gradual and the movements in various countries were usually in the same direction.

6. Scarcity economics reigned supreme throughout the pre-1914 period. No Government was likely to inspire distrust in its monetary policy by embarking on expansionism, whether for the purpose of increasing production or for the sake of social welfare. The conception that in matters of finance one has to cut one's coat according to one's cloth was virtually unchallenged, and there was no pressure to persuade the Governments that they were in a position to increase the quantity of their cloth at will While occasionally various Governments unbalanced their budgets, this was due to their inability to raise sufficient revenue and not to any deliberate policy It appeared incon-

ceivable that a Government should endanger the stability of its currency for the sake of pursuing an ambitious monetary policy.

7. Finally, discrepancies in international accounts were balanced with the aid of international loans and credits which were readily forthcoming. Had it not been for the willingness of countries with export surpluses to grant long-term loans to countries with import surpluses, monetary stability would have broken down during the nineteenth century in spite of the operation of the gold standard, and that system would have failed in most if not all countries. It was because millions of investors in Great Britain, France, Germany, Belgium and Holland were willing to subscribe to foreign loans and to buy foreign shares that the gold reserves available were on the whole sufficient to meet deficits in the balances of payments.

It is necessary to realise, moreover, that while the nineteenth century conditions were almost ideal from the point of view of international monetary stability, they were far from satisfactory from the point of view of internal economic evolution The rigid rules of the gold standard, under which the volume of currency and credit had to be related to the volume of gold, handicapped production and delayed progress towards prosperity The handicap would have been much graver had it not been for the accidental discovery of the world's most important gold deposits during the nineteenth century in California, the Rand, and Alaska. Thanks to a series of gold rushes it was possible during the nineteenth century to finance the construction of the modern railway system, the development of vast industries and townships, and to add in many other ways to the wealth of mankind. Had the gold deposits in North America and South Africa not been discovered, the orthodox monetary conception would have prevented the creation of these highly valuable assets, and the progress of human welfare and civilisation would have been delayed in spite of the technical inventions which had made it possible. Even as it was, progress was not achieved to the limit of capacity set by the factors of production. The experience of the rapid industrialisation of Soviet Russia and Japan between the two wars, the spectacular re-armament drive of Germany between 1933 and 1939, and the equally spectacular drive of Great Britain between 1940 and 1943, proves that industrial expansion can be much more rapid if unhampered by an orthodox monetary policy.

Moreover, stability in exchanges was often achieved at the cost of sacrificing internal stability. Our generation has every reason to remember the experience of 1929 when, under the gold standard game, it was considered necessary to put up interest rates and paralyse home trade in order to maintain the stability of exchanges in face of pressure due to Wall Street speculation. Such instances occurred also during the period that ended with the war of 1914. From time to time interest rates had to be raised to a level entirely unjustified by the state of home trade, merely because financial developments in some other country had led to an outward flow of funds.

It is an open question whether even from the point of view of the volume of foreign trade it would have been more advantageous during the nineteenth century to adopt a less orthodox system. Admittedly the expansion of foreign trade was greatly assisted by the foreign exchange facilities provided under the gold standard. On the other hand it was handicapped by limitations of purchasing power and productive capacity which were accepted as inevitable under the gold standard. Conceivably under the stable political conditions of the last century it might have been possible to attain a much larger volume of foreign trade under the system of planned economic and monetary expansion. In any case, stable as the foreign exchange system of the nineteenth century undoubtedly was, it carried within itself the germs of those destructive tendencies which became so painfully evident between the two wars. Speculation in foreign exchange was not invented in 1919. It existed throughout the nineteenth century, though it was confined to currencies such as the Russian rouble, which were apt to become unstable from time to time. In accordance with the teachings of classical economics such speculation as existed during that period had its economic justification in that it bridged the time lag between supply and demand. Amidst the stable conditions prevailing in the nineteenth century, speculators who bought currencies when they were in excessive supply and sold them at a profit when they were in good demand, were considered to have fulfilled a useful function. This conception died hard, and it found wide acceptance even during the destructive speculative activities of the 'twenties and 'thirties. Had it not been for the unduly favourable view taken of speculation by classical economists, its viciousness might have been realised sooner after the last war, and it would not have taken the best part of two decades to discover the necessity of stamping out speculation in foreign exchange in the interests of stability and progress.

The war of 1914 brought the easy-going attitude towards foreign exchange temporarily to an end. Restrictions of varying degrees were adopted by all belligerent countries. Exchange rates were officially controlled and, apart from the neutral foreign exchange markets, speculative activities came virtually to a standstill The restrictions were regarded, however, by everybody as a temporary evil which had to be accepted amidst war conditions, but which would be removed as soon as the war was over. Everybody was longing to return to free foreign exchange markets which had operated so satisfactorily before the war. When the war was over most countries took the first opportunity to remove or substantially relax restrictions, even though in many instances the ensuing currency chaos necessitated a return to the régime of control. The freedom to make mischief by engaging in speculative activities was considered sacrosanct during the early 'twenties, even though the evil effects of such activities were by then evident.

At the Genoa conference of 1922, when the financial experts of all countries pooled their brains to lay down the rules on which sound monetary policy should be based, a resolution was passed emphatically opposing any restriction of activities in foreign exchanges. In subsequent years every country, from the weakest to the strongest, had to pay the price for this resolution, as none of them escaped the disastrous consequences of foreign exchange speculation. Foolish as the wise men of Genoa may appear in our eyes, their collective wisdom was but the natural outcome of experience gained during the nineteenth century. What these men failed to realise was that fundamental conditions which made free exchanges possible before 1914, disappeared for good after 1918.

Those who expected during the last war that currency conditions would return after the war to what they had been until 1914, soon discovered that from 1918 onwards they lived in a different world. The period of stability was gone and never returned again, apart from brief periods of uneasy equilibrium between crises. For one thing, inflation during and after the last war resulted in unsettled internal conditions in some countries It also increased the liquid resources of the public available for transfer abroad. The volume of gold increased, but not nearly to the same extent as the total volume of fictitious resources which were liable to become the subject of international transfers Confidence in internal and international stability disappeared. A large number of people in Europe became anxious to safeguard themselves against political or financial disturbances, high taxation, or anti-capitalist measures by Socialist Governments, by transferring their capital to safer countries. This restless "funk money" shifted backwards and forwards between various financial centres almost incessantly during the period between the two wars. Its disturbing influence on foreign exchanges became accentuated by speculative activities which from time to time assumed sweeping proportions The disparities between price levels in various countries and the conflicting monetary and economic policies of the various Governments were additional powerful unsettling factors Transfers of reparations and war debts added to the abnormal influences operating in the foreign exchange markets.

Above all, the consolidation of surpluses by creditor countries by means of loans and credits to the debtor countries was not systematically pursued The principal creditor country, the United States, was unwilling to accept payments in goods, and while for some time she readily re-lent her surplus to her debtors, she abruptly ceased to do so in 1930. In the following year the United States, and to a less extent other creditor countries, attempted to withdraw the short-term funds lent abroad, and the result was an unprecedented financial crisis and a relapse into the currency chaos from which the world had emerged with some difficulty during the 'twenties.

A situation had arisen in which the foreign exchange system ceased to be able to serve the requirements of foreign trade. In a number of countries a moratorium was declared on external payments, including payments due on current commercial account. The claims of foreign creditors were blocked, and this, together with the wild fluctuations of the exchanges, undermined that confidence that is essential for the smooth operation of international trade. Many countries reverted to some form of barter in international relations in order to make sure that they could pay for what they purchased abroad and that they received payment for what they sold abroad Most countries adopted some form of exchange control The difficulty of importers in obtaining exchange for payment for imports and the risk for exporters of receiving no payment for years, if at all, paralysed foreign trade to a much larger extent than all the customs tariffs and quotas adopted by various countries.

To overcome these difficulties the exchange clearing system was gradually adopted by a large number of countries from 1931 onwards. It assumed almost entirely the form of bilateral clearing which was an advanced form of barter. Notwithstanding the many theoretical objections to it, the system went a long way towards overcoming the deadlock that threatened international trade, especially in Central and South-Eastern Europe. The alternative to trading on the basis of bilateral clearing was in the circumstances not free trade (as orthodox dogmatists would have liked us to believe), but no trade at all. It was, thanks to this primitive form of clearing, that a fairly substantial volume of trade was maintained by financially weak countries. The system was admittedly far from ideal Although the forcing of trade into bilateral channels provided some degree of security for weak countries during a very difficult period, at the same time it created artificial situations in which more expensive goods or goods of inferior quality were bought on clearing account in preference to cheaper and better goods available for countries which were in a position to deal on a cash basis In later years, Germany abused the peculiar character of the clearing system for exploiting the countries within her *Lebensraum* and for securing for herself an economic and political stranglehold over them. Notwithstanding this, exchange clearing provided an interesting alternative to the old method of international transfers through the free foreign exchange market. Its possibilities were not at first realised either in the financially weak countries which adopted it as an emergency measure, or in the financially strong countries which resorted to it in isolated instances for the purpose of collecting debts which could not otherwise have been collected. It took some time before the world realised that exchange clearing was not a mere palliative but the modern and rational system of international transfers.

Another device which went some way towards making conditions in 1931 tolerable was the Exchange Equalisation Account. Government intervention in the foreign exchange market was no innovation. On many occasions during the 'twenties the monetary authorities of various countries felt compelled to take action in defence of their national currencies. It was only from 1932 onwards, however, that Government intervention came to be pursued systematically. The reflux of funds which left London during the crisis of 1931 provided an opportunity for the British Exchange Equalisation Account to accumulate a large gold and foreign exchange reserve. In possession of such a reserve, it was able to do what its name implied. to equalise the effects of the international trends of funds on both exchange rates and money market conditions. In doing so, the British authorities removed one of the outstanding defects of the old monetary system. Before the last war, and even before 1931, the stability of exchanges in face of international movements of capital was safeguarded at the cost of unstable interest rates. Thanks to the functioning of the Exchange Equalisation Account it became possible to maintain a fair degree of stability of exchange rates and an almost ideal stability of interest rates. Whenever there was an outflow of funds, the authorities no longer sought to stop it by raising the Bank rate, but simply drew upon their reserves to buy the sterling offered for sale in the foreign exchange market. Under the new system the movement was not accompanied by any contraction of credit, and thanks to the technique with which the resources of the Exchange Equalisation Account were handled it left interest rates unaffected. Indeed, from the middle of 1932 until August, 1939, the Bank rate remained unchanged at 2 per cent. while bill rates declined to the unprecedented level of ½ per cent.

The reason why it was possible to achieve this result was that the British authorities possessed substantial gold and foreign exchange resources with the aid of which they were able to afford to provide dollars for anyone who chose to transfer his funds to the United States. Another reason was the traditional confidence of British people in the inherent stability of sterling, thanks to which the authorities were not confronted with the task of providing foreign exchange for a flight of British capital in addition to the periodical flights of foreign capital.

The system of Exchange Equalisation Account (which was adopted by the United States, France, Holland, Switzerland, and other countries with substantial reserves) was a useful device for rich countries. In spite of this, general pre-war monetary conditions left much to be desired. This was partly because all countries were not in a position to maintain stability owing to their lack of adequate resources, and partly because fundamental factors resulted in, from time to time, a disequilibrium even between the principal currencies which were technically well served by the system of the Exchange Equalisation Account. That system was decidedly a rich man's system, and since the majority of countries could not afford it, it failed to provide a universal solution of the foreign exchange problem. Even from the point of view of rich countries, a system which can only be operated in a few countries is far from ideal. Although the currencies which are not protected by the Exchange Equalisation Account may be of secondary importance, total trade with all these countries is of primary importance.

The system of Exchange Equalisation Accounts was not primarily meant to solve the problem of providing for the foreign exchange requirements of international trade, but only to iron out the effects of international movements of funds and speculative operations. In so far as the operation of Exchange Equalisation Accounts resulted in a higher degree of stability of the exchange rates, it assisted foreign trade. During the first four years of its existence, however, the British Exchange Equalisation Account did not aim at such stability. In order that foreign trade should be spared the effects of instability, currency groups were formed during the 'thirties to secure for their members the benefit of stable exchange rates, at least within the groups. Both the Sterling Bloc and the Dollar Bloc included a number of countries representing a fair share in world trade. Many countries remained, however, outside these Blocs. Their trade tended to become bilateral in relation to similarly placed countries.

Another major deficiency of the pre-war monetary system was the inclination towards a currency depreciation race. Every now and then fundamental internal economic conditions led to the overvaluation or undervaluation of a currency in relation to its purchasing power parities. This means that the price level and the cost of production in some countries became much higher than in rival countries. From time to time these discrepancies were adjusted by means of a devaluation of the national currency which was overvalued. During the 'thirties currency depreciation with the object of improving the exporting capacity of the countries concerned became a favourite sport.

This practice was far from universal. Some countries made desperate attempts to defend their currencies at their overvalued level irrespective of the cost of such a policy in terms of sacrificed prosperity. The result of the prolonged defence of a currency at an overvalued level was that when its defence had to be abandoned it was necessary to make a very substantial cut. In some instances the prolonged defence of the currency created such unsatisfactory conditions that more than one devaluation became necessary. Owing to the prevalence of competitive currency depreciation, devaluation was resented by other countries even when it was fully justified. An atmosphere of suspicion and mutual recrimination developed and it affected unfavourably the international political atmosphere.

In some cases the unduly prolonged defence of overvalued currencies resulted in a financial and economic crisis producing grave political consequences. Thus the short-sighted policy of Dr. Brunnig in defending the reichsmark at its old parity in 1931-32 was largely responsible for the wholesale unemployment which brought in Hitler. The desperate efforts of France between 1934 and 1936 to defend the franc by means of ruthless deflation cost the French nation its security and its independence, because, for the sake of keeping down the budgetary deficit, the defence services were starved of funds during the critical period while Germany was rearming rapidly.

Thus at the one extreme we had light-hearted devalutions uncalled for by fundamental economic conditions, effected for the purpose of securing commercial gains, whilst at the other extreme we had stubborn resistance to natural trends making for a depreciation of the national currencies.

An attempt was made to regulate this state of affairs by the conclusion of the Tripartite Currency Agreement between the United States, Great Britain, and France in 1936. Under the terms of this agreement the participants had to undertake to abstain from competitive currency depreciation; at the same time it was understood that the participants would raise no objection if the other partners effected devalutions justified by their internal conditions. This system failed to satisfy the hope attached to it, partly because the number of countries which adhered to it was limited, and partly because it was unable to eradicate suspicion and selfishness amongst its members. There was a tendency towards a very narrow interpretation of the agreement.

In the spring of 1938 the French franc was stabilised after repeated devaluations, and during the eighteen months that preceded the outbreak of war a fair degree of exchange stability prevailed. This stability was, however, not due to any fundamental equilibrium. Beneath the apparently smooth surface factors were at work which would have unsettled conditions even if the war had not broken out.

The unconventional trading and foreign exchange methods of Germany enabled her to gain ground at the expense of Great Britain and other countries working with more conventional methods. By making large purchases and then refusing to pay unless her goods were accepted in payment, Germany succeeded in penetrating even into the British Dominions to a disconcerting degree. Obviously, the dice were loaded in her favour. More or less conventional methods of trade and foreign exchange failed to enable Great Britain to increase her exports sufficiently to cover abnormal imports due to rearmament. Owing to this and to the reluctance of the United States to authorise a much-needed downward adjustment of sterling, the foreign exchange resources of the British authorities declined considerably during the last pre-war years, with the result that Great Britain entered the war with an inadequate foreign exchange reserve, which became virtually exhaused after little more than a year of fighting.

The improvements in the currency system brought about by the various innovations during the 'thirties were admittedly considerable. In the changed circumstances the system operating shortly before the war was incomparably more adequate than the old system. Nevertheles, it had the great failing of allowing a free hand to speculators and those wishing to transfer funds from one country to another. It was the height of absurdity that when unstable political conditions tended to stimulate disturbing tendencies in foreign exchange markets, some Governments failed to take steps to safeguard vital financial interests in face of these trends The dogmatic belief in the freedom of foreign exchange dealing was so deeply rooted that they were prepared to jeopardise national security rather than interfere with the game of gamblers and owners of "funk money" The reason why this country did not have to pay a heavier price for its shortsighted dogmatism in this respect before the war was that, being in possession of large gold, foreign exchange and foreign investment holdings, it could afford to be short-sighted Liquid or easily realisable foreign assets provided a convenient shock-absorber and postponed the day when the need for a rational foreign exchange system came to be realised.

CHAPTER III

FOREIGN EXCHANGE DURING THE WAR

THE war brought about a fundamental change in the currency system of Great Britain and of most belligerent countries. The change was hardly perceptible in the case of Germany, because she already had adopted watertight exchange control long before the war. In Great Britain and the other democratic countries, however, the freedom of foreign exchange dealing was maintained to the very last. Although during the last pre-war years the reserves of Great Britain and France were weakened by the sweeping flight of capital to the United States, it was impossible to persuade the Governments to take action to safeguard the financial war potential of their countries. Even at the time of the Munich crisis, when war appeared to be imminent, no steps were taken to check the westward flow of funds

It was not until the actual outbreak of the war in September, 1939, that restrictions were adopted at last, and even then the measures taken were far from adequate. It was with the utmost reluctance that the British monetary authorities decided to depart from the régime of freedom of exchanges, and their decision was obviously half-hearted During the first year of the war the exchange restrictions were far from watertight, indeed, almost anybody wanting to evade them could do so with impunity. The authorities did not go out of their way to stop the loopholes, nor to catch offenders against exchange regulations, nor even to inflict adequate punishment on them if they happened to be caught. It was openly admitted in official circles that if exchange restrictions were to be made too effective it would be detrimental to London's positon as the world's banking centre after the war. And during the "phoney war" of 1939-40 this consideration prevailed over the necessity of safeguarding the country's dwindling dollar resources for vital war requirements. It was not until about the middle of 1940 that the Government realised that unless exchange control was reinforced there would soon be no dollars left for purchasing war materials in the United States. An effort was then made to tighten restrictions. To a large extent this amounted to bolting the stable door after the horse was gone. Nevertheless, it was better late than never, and after many a trial and error the exchange restrictions became for all practical purposes effective. Considering that Great Britain had no previous experience in exchange restriction the period of twelve months required for perfecting the new system cannot be considered excessive.

An essential change compared with the pre-war system has been the virtual cessation of unofficial capital transfers and the practically watertight control of transfers for commercial purposes. Before the war the role of the Exchange Equalisation Account was confined to supplying the market with the foreign exchange needed for capital transfers as well as commercial transfers, in so far as private selling did not provide a counterpart for the demand. During the war, demand through capital transfers was prevented, and demand through commercial operations was brought under control. The limited foreign exchange resources were thus safeguarded to meet vital requirements. To that end, the authorities assumed virtually a monopoly in foreign exchange dealing. Although the form of exchange clearing was not actually resorted to, in substance that system was adopted

As a result of a series of Payments Agreements concluded with practically all Allied and neutral countries, the proceeds of the exports to Great Britain had to be left in the form of blocked sterling balances, which could only be spent by importing British goods by the exporting countries. As a result of this arrangement the adverse trade balance of Great Britain did not lead to a depreciation of sterling in the black markets existing abroad. Such depreciation occurred during the early part of the war, when the recipients of sterling were at liberty to sell it wherever they could find a buyer. The Payments Agreements stopped this practice, and although foreign exporters were in a position to sell their sterling to their banks or to importers of their own countries, there was no international market for blocked sterling.

The Lend-Lease arrangement enabled this country to continue to import from the United States on a large scale after its dollar reserves were exhausted. Payments Agreements made it possible to import from Latin America, Spain and Portugal without having to find foreign exchange to pay for the import surplus. The countries wanting to export to Great Britain were prepared to accept blocked sterling in payment. Consequently, the adverse trade balance presented no immediate foreign exchange problem for the British authorities. At the same time, any pressure on their foreign resources through flight of capital or speculation was reduced to a minimum by the reinforcement of exchange restrictions.

An important development that proved to be of great assistance was the creation of the Sterling Bloc. It existed already before the war ever since the Ottawa Declaration of 1932 Until the war, however, it had relatively small significance. It only meant that members of the Sterling Bloc kept their foreign exchange reserves in London, and that their currencies were pegged in relation to sterling, and therefore fluctuated in sympathy with sterling. When the war broke out, however, the Sterling Bloc assumed an entirely new significance. All countries belonging to the group agreed to adopt exchange restrictions similar to those adopted by Great Britain. The transfer of funds between members of the Sterling Bloc was relatively free, so that from a monetary point of view the Sterling Bloc became one single vast unit in relation to the rest of the world This meant that as far as trade within the Sterling Bloc was concerned there were no foreign exchange difficulties. Needless to say, trade was gravely handicapped by lack of transport facilities and of exportable supplies, but lack of foreign exchange or unwillingness to accept blocked sterling in payment for exports was not added to these other difficulties. Amidst all war-time restrictions the Sterling Bloc, consisting of the British Empire (with the exception of Canada and New Foundland), the Free French Colonies, the Belgian Congo, the Dutch Colonies (in so far as they were not under Japanese occupation), Iceland and the countries of the Middle East, with the exception of Turkey and Afghanistan, formed one huge free exchange area.

On the other hand, in relation to the rest of the friendly and neutral countries, Great Britain and the Sterling Bloc became isolated from a monetary point of view. The sterling-dollar rate was fixed at an artificial level for the duration, and was not affected by any developments either in this country or in the United States. The question whether it was overvalued or undervalued in relation to its purchasing power parity did not arise, since foreign trade was largely artificial, and was not affected by the relative costs of production in the two countries. For a short while after its devaluation at the beginning of the war, sterling may have been undervalued, but owing to wartime difficulties British export trade was unable to take full advantage of this Subsequently, as a result of the rise in prices and costs in Great Britain, sterling became overvalued, but this again did not affect the trade balance Finally, after the entry of the United States into the war, the rise of the American price level resulted in a fresh undervaluation of sterling, but by that time privately conducted foreign trade became so restricted that this failed to produce any noteworthy effect. A world price level ceased to exist Each country had a price level which was independent of that of other countries. Even within the Sterling Bloc the reaction of the price level of one country to that of another was limited When it came to two countries belonging to different currency groups, they might almost have been situated on different planets for all the effect their price tendencies had on each other

What mattered was that the monetary isolation achieved by Great Britain enabled the authorities to finance the war by means of borrowing at a low rate of interest. Investors were deprived of investment opportunities abroad, and since public issues in the home market were strictly controlled, Government loans provided practically the sole investment opportunity for new capital. The Government was in a position to reduce and keep down interest rates on its own long-term and short-term issues, largely because investors had no choice. They were unable to send their money abroad if they were offered their higher yields. Admittedly, even before the war, between 1932 and 1939 the Government was able to maintain low interest rates in the absence of exchange restrictions. This was, however, because in possession of a large gold reserve the Exchange Equalisation Account was able to neutralise the effects of large-scale capital movement. In the absence of a gold reserve from 1940 onward, the Treasury would have had to resort to high interest rates had it not been for the fact that sterling was safeguarded with the aid of stringent exchange restrictions. It was thanks to these restrictions that the Government was able to reduce gradually its borrowing rate through the course of this war. During the last war the cost of borrowing gradually rose, while during this war it moderately declined.

What is perhaps even more important, the restrictions enabled the Government to inflate with impunity. Under the regime of free exchanges, a fraction of the inflation brought about by war finance would have been sufficient to cause a flight from the pound. The reserves of the Exchange Equalisation Account would have become exhausted, and the Government would have been faced with the choice between two evils. It would have had to allow sterling to depreciate, thereby causing a sharp rise in prices, or it would have had to raise interest rates to a very high level, thereby causing an increase in the cost of borrowing, without being able by such means to achieve the desired end Exchange restrictions saved the country from both these evils

Apart from other considerations, exchange restrictions during the war were essential to enable the Government to plan both foreign trade and domestic production. If the public were entitled to do as they chose with their money, their uncontrolled transfers or purchases abroad would be highly detrimental to the economic war effort. The experience gained during the war shows that by keeping international transfers and the internal money market under strict control, the authorities are in a position to plan economic activities to the best advantage of the community This lesson is well worth retaining.

CHAPTER IV

FOREIGN EXCHANGE AFTER THE WAR

BEYOND doubt, in comparison with the last war, the currency problem of this war has been solved satisfactorily. But then even during the last war some sort of temporary equilibrium was achieved, and it was not until after the Armistice that the real monetary troubles began to make themselves felt. It is no wonder, therefore, that those who are interested in monetary questions are not inclined to be unduly complacent, in spite of the reasonably satisfactory solution of the monetary problem during the war. As soon as it became evident that the monetary problem of the war was more or less solved, the experts began to think about post-war prospects.

In this respect, as in every other respect, there is sharp disagreement between those who considered the pre-war situation satisfactory, and those who are determined to bring about fundamental changes after the war There are many people who would like to return to the pre-war currency system. Some of them would be satisfied if the elastic system that existed between 1931 and 1939 were restored Others would go further and advocate a stabilised sterling, without returning, however, to the gold standard There is a small but vocal minority which demands the restoration of the gold standard as it existed between 1925 and 1931, while the extreme orthodox wing favours the return to the full automatic pre-1914 gold standard. In their opinion, the trouble about the pre-1939 system, and even the pre-1931 system, was not that it was too orthodox, but that it was not orthodox enough. They consider all war-time restrictions an intolerable interference with freedom, and while they may grudgingly admit that during the war exchange control is a necessary evil, they are convinced that once the war is over it would become an evil without being necessary They would like to see a return to a free foreign exchange market such as operated before the war; indeed, many of them even consider the operation of the Exchange Equalisation Account an unwarranted degree of Government interference with the foreign exchange market. They believe that the only way in which an unfavourable tendency in foreign exchanges should be adjusted is to allow interest rates to rise to a level at which the outflow of funds would give way to an inflow. This is in accordance with the teachings of classical economics, under which every disturbing trend produces its own corrective.

The extreme fanatical wing of this dogmatic school would like to abolish exchange restrictions immediately after the cessation of hostilities. They would like to follow the same policy as after the last war, hoping against hope that it might be possible to avoid the repetition of the currency chaos of the 'twenties through ruthless deflation and rigidly balanced budgets Whether public opinion would be prepared to put up with the wholesale unemployment and general depression and poverty caused by this policy is a question that is ignored by the monetary doctrinaires whose sole concern is to revert to the orthodox currency system. They would be even prepared to put up with a temporary currency chaos rather than with a temporary maintenance of exchange control after the war.

There is a wide variety of opinion among the less extreme advocates of free exchange dealing about the length of time during which exchange restrictions should be maintained and about the extent to which they should be maintained. The camp includes some advanced optimists who imagine that the various difficulties which will necessitate the maintenance of restrictions after the war will be overcome in a year or two. They appear to have forgotten that after the last war unsettled currency conditions continued to prevail in Europe for about ten years until 1928, when the last of the important currencies, the French franc, was stabilised. What is more, after three years of stability chaotic conditions returned in 1931 and continued, as far as the French franc was concerned, until 1938. In the circumstances, it would be more advisable to think in terms of decades rather than years when trying to forecast th length of the period for which exchange restrictions would be indispensable. It is a matter of opinion whether it would be to the best interests of mankind to remove exchange restrictions even after this has become possible. What is certain is that premature removal would plunge the world into chaos.

Some of the supporters of a return to the free foreign exchange market are aware that for many years to come there can be no question of a return to complete freedom. Accordingly, they advocate the relaxation of the exchange control immediately after the war pending its removal at a later date. They realise the necessity for continued control of capital movements, but urge the Government that commercial foreign exchange transactions should be freed of all restrictions. What they do not realise, however, is that it would be quite impossible to enforce effectively restrictions on capital movements unless commercial foreign exchange transactions are also subject to supervision. Even if applications for foreign exchange for genuine purposes become purely a matter of form and are granted automatically, the machinery for controlling such transactions must be maintained, for otherwise capital transfers will be carried out under the disguise of commercial transactions.

Some advocates of free exchange do not propose to draw any rigid line between capital movements and commercial transactions, but would prefer to see an all-round relaxation of the control. Such a policy would be, however, very foolish. If there is exchange control it must be effective, otherwise the existence of loopholes would encourage evasion, and the system would put a premium on disloyalty and would penalise loyalty. The whole question of exchange restrictions will be discussed in detail in Chapter XV.

While various shades of opinion of the orthodox school have been endeavouring to put the clock back, the host of monetary reformers has been by no means idle. Since the war has thrown the currency system into the melting-pot, they regard this as a heaven-sent opportunity for putting forward proposals which would not have stood a chance of being considered during a more settled period.

Some experts favour the maintenance after the war of the system that has been operating during the war. This attitude may appear conservative, since it consists of advocating the maintenance of the *status quo*. Since, however, the present system has been devised for war-time conditions, its continuance in time of peace would constitute in reality a radical change in the monetary system.

There is another school of thought according to which the solution of our post-war currency problems lies in the adoption of the system that was operated with great success by Germany before the war. This system was based on the existence of a large number of bilateral exchange clearing agreements. It is argued that thanks to that system Germany was able to maintain and increase her foreign trade before the war, and to maintain the stability of the reichsmark in spite of the almost complete absence of a gold reserve To some extent the system was adopted by Great Britain during the war, in the form of Payments Agreements, under which foreign countries are only able to receive payment for their exports to this country through the purchase of British goods of corresponding value This system has not been working satisfactorily during the war; owing to the export difficulties of this country, large amounts of blocked sterling balances accumulated in London. In normal conditions, however, when there are ample supplies available for export and adequate transport facilities, such a situation could not have arisen The countries exporting to Great Britain would have ample opportunities to recover their claims by buying an adequate quantity of British goods It is true, occasionally they would have had to buy British goods when they could have been able to secure corresponding foreign goods at a lower price, but then, according to the argument of the supporters of bilateralism, if they want to export they have to enable the importers to pay for their goods even if this should entail some slight sacrifice.

Some quarters have been advocating the development of the bilateral clearing system into a multilateral clearing system on the lines attempted by Germany in Europe and by Japan in Eastern Asia. Under that system a central clearing office is established for the purpose of offsetting against each other the debit and credit balances on the clearing accounts of the participating countries. If this system could be brought to perfection, it would mean virtually complete elimination of foreign exchange. The importers of every country would simply pay for their purchases in their own national currency to their own monetary authorities, and the various claims and counter-claims arising from foreign trade would be settled by bookkeeping entries at the central clearing institution. Neither the German nor the very inadequate Japanese experience has succeeded in producing any evidence to prove that such a degree of perfection could be achieved. Indeed, the results of both experiments have been so utterly unsatisfactory that they tend to discredit the system to an unjustified degree. Supporters of the system point out that its merits should not be judged by the German and Japanese experiments, because their aim was simply to exploit the subject races through acquiring their goods without payment. The multilateral clearing system was abused to that end, and vast frozen debts were incurred on clearing accounts by the two ruling races in relation to the subject races In such circumstances the system could not possibly be expected to function satisfactorily. Be that as it may, the fact remains that the German system is under a cloud, and its adoption, even in a modified form which would exclude abuses, has received but scant support in democratic countries.

A much more popular suggestion is for the foundation of currency groups. Such currency groups have already been in existence for some time. Most important amongst them has been the Sterling Bloc, the Dollar Bloc, the Yen Bloc and the Reichsmark bloc Under Hitler's "new order," it was proposed that the world should be divided into groups of countries which would trade with each other as vast units. There would be, of course, German-controlled Europe, Japanese-controlled Asia, Great Britain with such portions of the Empire as would be left to her, and the Pan-American Union.

Various experts and organisations have been putting forward post-war currency schemes, none of which received, however, serious consideration. There was, for instance, the multilateral clearing proposal of the London Chamber of Commerce. There was also the ingenious and generous scheme put forward by Mr. Herbert Feis, Economic Adviser to the Washington State Department. Unfortunately, he put it forward in his individual capacity. It was easily the most liberal scheme ever conceived. In substance, it amounted to the suggestion that each country should grant two years' credits to every other country in terms of its own national currency, for the purpose of enabling other countries to buy its goods. If by the end of two years any credits were not fully used, the unused part would be cancelled. Thus, if a creditor country did not collect its claim by importing goods from its debtor country, then his claim would lapse after two years. Since there is not the slightest chance of the adoption of this principle by the largest creditor country, the United States, it is not worth while to examine the details of this fascinating suggestion.

At the beginning of 1943, a scheme for multilateral exchange clearing was put forward by the Nuffield Institute. It was elaborated by a German refugee economist, Mr. Schumacher. Under this scheme, the participants in the arrangement would undertake to accept payment for their exports in any national currency instead of insisting on payment in gold or their own currency. In practice, this would mean that the strongest country with a net export surplus would accept payment in the currency of the weakest country with a net import surplus. There is little likelihood of any such scheme being accepted, even though some of its features were identical with the official British and American schemes subsequently put forward.

There were a number of other private proposals indicating the trend towards some form of multilateral clearing. As the British proposal for an International Clearing Union rightly pointed out, the multilateral clearing scheme is based on " certain general ideas belonging to the contemporary climate of economic opinion and are born of the spirit of the age."

The first indication that official minds were working in the same direction as private suggestions was given by the Chancellor of the Exchequer in his speech in the House of Commons on February 2 1943, in the course of which he declared that we need " an international monetary mechanism which will serve the requirements of international trade and avoid any need for unilateral action in competitive exchange depreciation . . a system in which blocked balances and bilateral clearings would be unnecessary . . an orderly and agreed method of determining the value of national currency units. . . . We want to free the international monetary system from those arbitrary, unpredictable and undesirable influences which have operated in the past as the result of large-scale speculative movements of short-term capital."

When he made this statement it perplexed the public to no slight degree. Before very long, however, the official attitude towards post-war currency problems was clearly defined. In March, 1943, it was announced that representatives of Allied Finance Ministries had been invited to a conference at the Treasury to elaborate a post-war currency system. Subsequently, it transpired that the system proposed was the Keynes Plan. The following chapters of this book are devoted to the examination of that proposal.

CHAPTER V

THE BRITISH CURRENCY PLAN

In April, 1943, an epoch-making document made its appearance, in the form of a White Paper entitled, "Proposals for an International Clearing Union." It contained what has come to be known popularly as the Keynes Plan for a post-war currency system. Some months before its publication some particulars transpired indicating the revolutionary nature of the proposed reform. Various more or less informed forecasts suggested that the system which the Treasury intended to propose, on the advice of Lord Keynes, was that of multilateral clearing; that it would provide for the establishment of an international currency and for the creation of an international financial institution; and that it would provide extensive credit facilities for the benefit of impoverished countries after the war.

It goes without saying that these forecasts aroused the interest of expert and layman alike, and the appearance of the document was eagerly awaited. Nor were experts and the public disappointed, for when the Plan appeared it was found to be of sensational interest. Unfortunately, the average man in the street considered it too technical to understand it properly, but was nevertheless able to realise its great significance. As for the experts, they devoured the contents of the twenty pages of the White Paper, and during the following months they were kept fully engaged in explaining, analysing and criticising the scheme.

To the expert, the Keynes Plan is indeed a fascinating document. The more one reads it the more one discovers in it. Indeed, nobody could possibly do justice to it by reading it through once, however carefully. It is unusually stimulating and many volumes could be filled—as, indeed, probably will be filled before very long—by enlarging on the innumerable points, both fundamental and technical, raised in the report

It is in every way an inspiring document, as it is bound to be, considering that Lord Keynes is its main, if not only, author

Beyond doubt, many of the principles and details of the Plan are open to criticism. All the shortcomings the Plan may have do not affect, however, the greatness of its conception. The Plan modestly disclaims originality. In order to forestall any charge of plagiarism, which some ambitious and vain authors of earlier plans might conceivably make, the proposals are merely described as an attempt to reduce to practical shape ideas which have been published recently by writers of several different nationalities. In reality, the Plan is much more than it claims to be. While previous proposals on the subject of international clearing amounted to mere palliatives or technical devices, the Keynes Plan constitutes a fundamental revolutionary innovation with a profound philosophical background.

Admittedly, there is a great deal in the British Plan which is purely empirical. The original Keynes Plan had to be touched-up in the light of criticisms by various Treasury officials and other Government experts, and also to satisfy the Dominions Governments, to which it was submitted before it was drafted in its final form. In any case, Lord Keynes himself must have been aware of political and practical considerations when drafting his original scheme. It would be interesting to compare his original draft with the finished product, and even more interesting to know what exactly Lord Keynes, the economist, thinks of the scheme put forward by Lord Keynes, the Treasury adviser. Beyond doubt, if he were an academic economist and nothing more, and if he had the pleasant but somewhat futile task of drafting a scheme for an ideal world where politicians and the public were sensible and vested interests were unselfish, the plan would have been different. As, however, Lord Keynes, in his capacity of Adviser to the Treasury, was fully aware of the political considerations which had to be borne in mind, all he could do was to produce the best scheme that stood a chance of being accepted. What is surprising is not that the scheme contains so much that is opportunistic and empirical, but that it contains nevertheless so much that would be acceptable even to academic economists planning for an ideal world.

The aims of the Keynes Plan may be summarised as follows:

1. To facilitate monetary expansionism both on a national and international scale.

2. To restore conditions of multilateral trade such as prevailed during the nineteenth century and until the last war

2. To ensure international monetary stability tempered by a reasonable degree of elasticity.

4 To discourage the tendency of economically strong countries to export without importing to a corresponding degree, and also the tendency of economically weak countries to run up international indebtedness in an irresponsible fashion.

5. To provide credit facilities for countries impoverished by the war, in order to tide them over passing difficulties.

In addition to the above objects the scheme is to pursue a number of auxiliary objects. The Clearing Union is to act as banker for the various international organisations which are to be set up after the war for the purpose of stabilising the international price level, regulating the flow of international investment, etc. The authors of the scheme also envisage the possibility of the Clearing Union playing an active part in enforcing international sanctions against disturbers of the international order. All this is purely incidental and does not form an essential part of the scheme itself. We propose to confine ourselves in later chapters to the examination of the fundamental objects of the Plan.

The provisions proposed in order to achieve the objects in view may be summarised as follows:—

1. An international bank will be established under the name of International Clearing Union. While originally participation would be confined to the United Nations, the aim is to include all nations, both neutral and ex-enemy. The Clearing Union would be under the control of the Treasuries, which would determine its policy. It is not meant to deal with private individuals or firms, only with Governors, Central Banks and other officially controlled institutions. For the most part it would conduct its business with Central Banks.

2. The Clearing Union would create an international currency of its own named "bancor." It would not issue bancor notes, but would grant the participating Central Banks credits in terms of bancor, and these credits would be transferable between the

accounts of the Central Banks of participating countries. Bancor is not meant to be a currency for the use of international trade or even an international unit of account for private purposes. Nobody but the Governments, Central Banks and other official bodies having direct dealings with the Clearing Union would transact business in bancor. The bancor would not be convertible into gold or any national currency, though the clearing Union would have the right to sell gold or exchanges against bancor. On the other hand, the Clearing Union would be under legal obligation to buy gold against bancor at a fixed price

3 Participating Governments would have to agree to accept payment due to their countries in the form of a transfer of bancor Through this provision, bancor would be able to play the same part as gold in the settlement of trade balances

4. Participating States would be entitled to overdraw their bancor accounts up to the limit of their quotas. These quotas would be fixed on the basis of their pre-war foreign trade. The initial quotas would be equal to 75 per cent. of the average foreign trade for the three pre-war years. In the case of the United Nations alone the total of the quotas thus calculated was estimated by Sir Kingsley Wood at 25,000,000,000 dollars. In practice, participating States would not be able to use freely more than 50 per cent of their quotas If they exceed that limit the Governing Board of the Clearing Union would ask them to take various steps aiming at the reduction of the overdraft If the participants failed to comply with the measures suggested, they would not be entitled to increase their overdraft further

5. The quotas of member States would also determine their relative share in the control and management of the Clearing Union The Report emphasises, however, that the control should be allotted in such a way as to prevent any country or group of countries from achieving a dominating position at the expense of the rest

6. The value of the bancor would be fixed in terms of gold, but the Governing Board would have the right to alter it

7. The value of the currencies of the participating countries would be fixed in terms of bancor, and since the bancor represents a definite quantity of gold, the currencies would thus be linked to gold. The member States would agree between

themselves about the initial value of their currencies in terms of bancor and gold, but once the value of the various national currencies has been fixed it could not be changed without the permission of the Governing Board, except if the debit balance of a country with the Clearing Union has exceeded quarter of its quota for at least two years, in which case it should be entitled to devalue its currency up to 5 per cent During the first five years after the adoption of the system, the Governing Board would give special consideration to requests for an adjustment of the parities on the ground of circumstances which were unforeseen when the initial parities were fixed.

8. If the overdraft of a member State should exceed three-quarters of its quota for at least a year, and if it should fail to comply with the measures suggested by the Governing Board, it might be declared to be in default. In this case it would no longer be able to enjoy additional facilities, but would remain responsible for the liabilities incurred under the plan.

9. In order to discourage surplus countries from accumulating their surplus in the form of a credit balance in bancor instead of reducing it through spending or lending abroad more freely, the report somewhat hesitatingly suggests to charge a negative interest rate of 1 per cent. on credit balances, the same rate as would be charged on overdrafts. In addition, if the credit balance of a member State has exceeded half of his quota for a year, the Governing Board would suggest measures by which the surplus country could reduce its bancor credit balance. These measures include the deliberate increase of the domestic price level through credit expansion and the creation of additional purchasing power in the country concerned; the increase of the value of its currency in terms of bancor, gold and other national currencies, in order to stimulate imports and handicap exports; the reduction of tariffs and other obstacles to imports, and the granting of international loans which would consolidate the floating claim represented by the bancor balance

10. In order to correct unwanted inflationary or deflationary world trends, the Governing Board would be entitled to change the gold value of the bancor or to reduce or raise quotas of members in the same specified proportion.

11. The Governing Board would be entitled to ask the

member States for any relevant statistical or other information, in particular concerning holdings of gold, external credit and debit balances and other external assets and liabilities, both public and private.

12. The Governing Board would be appointed by the Governments of the participating countries. Those with larger quotas would be entitled to appoint a member individually, and those with smaller quotas would appoint a member representing a political or geographical group. The Governing Board would meet alternately in London and Washington. It would appoint an executive, the offices of which would be situated in London and New York At the annual assembly of the Clearing Union each particular State could be represented individually.

13. Members would be entitled to withdraw from the Union on a year's notice. Should they have a bancor overdraft outstanding they would have to settle it. Should they have a bancor balance they could liquidate it by using it in payment for an import surplus.

14. The Central Banks of non-member States would be allowed to keep bancor accounts with the Union, but would not be entitled to overdraw their accounts, and would have no say in the management of the Union.

In the subsequent chapters we propose to examine how far the above provisions are likely to achieve the five main objects enumerated at the beginning of this chapter. This detailed examination will provide an opportunity for enquiring into both the fundamental aspects of the Plan and the proposed technique of its operation

CHAPTER VI

MONETARY EXPANSION UNDER THE KEYNES PLAN

THE most important aspect of the Keynes Plan is that it aims at increasing the degree to which monetary expansionism can be proceeded with safely. With the progress of industrial technique and efficiency, and the increasing realisation of the need for an all-round improvement of the standard of living, it has become imperative to remove obstacles to an expansion of production which has now become both technically possible and politically necessary. The main obstacles to increased production are no longer lack of raw materials or labour or producing capacity. These obstacles can be overcome in time of peace. What handicapped production before the war was the inadequacy of financial facilities available to producers and consumers. It will be the supreme task of statesmen and economists during the post-war years to elaborate a system under which productive capacity can be utilised to the utmost limit and under which consumers are enabled to buy everything that can be produced The Keynes Plan, and, indeed, any currency proposal, must be examined in the first place from the point of view of whether it contributes towards achieving this end.

For well over two decades Lord Keynes has been regarded as the leader of the school of monetary expansionism. According to this school the monetary system must be devised in such a way as to prevent it from restricting productive economic activities. Throughout the nineteenth century and during the early part of this century the volume of credit was determined by the amount of gold available for monetary purposes. Lord Keynes and the various shades of monetary expansionists urged after the last war that instead of this automatic system a system of scientific monetary management should be adopted. Under it the volume of credit should be determined by the requirements of trade, independently of the volume of gold available. This conception has now been widely if not generally accepted Even before the war, between 1931 and 1939, the volume of credit in Great Britain and many other countries was determined entirely independently of the wide fluctuations of the gold reserves. Even though expansionists may rightly think that during that period the British credit policy was too timid, since no adequate financial means were provided for achieving full employment, the fact remains that the principle of scientific monetary management took the place of that of the automatic system based on gold.

Several other countries took a much bolder course. In Soviet Russia an unprecedented industrial revolution was carried out within twenty years without regard to the limitations of financial resources. But even in countries which retained the capitalist system, spectacular developments occurred on similar lines. The industrial revolution in Japan has been hardly less spectacular than that of Soviet Russia. The re-armament drive of financially bankrupt Germany between 1933 and 1939 was carried out independently of the financial factor. The United States, setting aside orthodox financial considerations in pursuance of President Roosevelt's New Deal policy, succeeded in recovering from the worst industrial depression of history In Great Britain it was not until after the outbreak of the war that an advanced monetary policy was adopted, leading to a remarkable expansion of the arms output between 1940 and 1943.

It is widely hoped that after the war Great Britain will continue to pursue a bolder policy than she pursued before the war, and will aim at providing the volume of credit necessary for the achievement of full employment. Apart from economic considerations, this will be a political necessity, since in recent years the British public has realised that it is possible to expand production through departing from financial orthodoxy. While after the last war the victims of a narrow and misguided monetary policy meekly submitted to their fate in the belief that there was no alternative, they now realise that the remedy is in their hands No Government will be able to face the country unless it takes into account the changed attitude of the public

The system of monetary expansionism, as conceived before the Keynes Plan, has two shortcomings. The one is that the capacity of Governments to expand credit with the aid of their central banks and banking systems ceases at the borders of the country. While credit required for producing goods internally can be created, so to speak, out of the blue, the authorities are powerless to create credit for purposes of buying goods abroad. And since internal expansion necessitates the import of added raw materials and manufactures, the impossibility of expanding credit for international purposes tends to restrict the degree of internal expansion itself. The other disadvantage of internal monetary expansionism is that in many ways it conflicts with the interests of international trade. Indeed, it has become a commonplace to argue on the lines that internal expansion can only be achieved by sacrificing foreign trade. The rising trend in costs brought about by internal expansion tends to handicap exports and to disrupt the international price level.

The Keynes Plan for an International Clearing Union aims at overcoming the national limitations of monetary expansionism. It is the logical application of the principles of expansionism in the international sphere One of the main objects of the Keynes Plan is to make it possible to create monetary facilities for international purposes in the same way as the adoption of internal expansionism has created monetary facilities for internal purposes. In the international sphere trade activity still depends on the volume of gold. Countries whose imports tend to exceed their exports are limited in their purchases by the amount of gold at their disposal, just as they were limited in their internal activities in the past by the volume of gold determining their volume of credit. The Keynes Plan aims at enabling deficiency countries to import well in excess of their gold resources. Under it, the requirements of international trade are to determine the volume of the means of payment available for international trade, just as the requirements of internal trade now determine the volume of currency required by internal trade.

The advantage of the Keynes Plan is that it expands the gold resources of the countries which most need such expansion. It enables deficiency countries to continue to buy goods abroad, in spite of the maldistribution of gold which places international purchasing power in the hands of countries which have no immediate use for it and which deflates the international purchasing power of deficiency countries which would be only too glad to import more goods. Under the Keynes Plan a very substantial amount is added to the world's total international purchasing power This in itself tends to produce an expansionary influence. This expansionary influence would affect in the first place international trade, but we propose to show that it also tends to affect internal trade considerably.

Another way in which the Keynes Plan tends to cause an expansion of international purchasing power is through increasing the velocity of circulation of the international means of payment We know that in the internal monetary system the increase of the velocity of circulation of money—that is, the frequency with which money is spent—tends to create the same effect as an increase of its quantity. The same is true also in the international monetary sphere If countries accumulating the proceeds of an export surplus can be induced to re-spend those proceeds, then the effect is the same as if additional international means of payment had been put into circulation To take a concrete example, if the United States, instead of accumulating the proceeds of her export surplus, is induced to spend it abroad, then the countries in which that surplus is spent will gain possession of international purchasing power just as if they had discovered a gold mine on their territory. Now, one of the principal aims of the Keynes Plan is exactly to induce surplus countries by various means to spend their accumulated surpluses. To the extent to which it would succeed in doing so it would add to international purchasing power.

The expansion of international purchasing power is bound to assist internal expansion. This is a matter of considerable importance. Most expansionists refuse to admit even to themselves that internal expansion has its limitations in the absence of a simultaneous expansion of foreign trade. Indeed, some expansionists consider it inevitable that internal expansion should be accompanied by a contraction of foreign trade, owing to the fact that it tends to raise the domestic price level above the world level, and thereby to discourage exports. The result is a strong trend towards autarky. Thanks to the Keynes Plan, it should be possible to avoid such a reaction on foreign trade, or at any rate to mitigate it up to a point—that is, provided that the Plan is interpreted in the right spirit. The Keynes Plan will enable countries engaged in internal expansion to continue to increase their imports even if their expansionary monetary policy should lead to a contraction of their exports. Needless to say, there are limits beyond which it cannot produce such an effect. After all, the facilities under the Keynes Plan are not unlimited, and if the price level of the country engaged in internal expansion should rise considerably above the world level, the trade deficit that would thus arise would sooner or later exhaust the facilities. The advantage of the Keynes Plan is that the stage a which internal expansion is checked by lack of means to pay for the imports needed for the growing home trade would be reached much later than it would be reached otherwise With the aid of the bancor credits the participants in the scheme would be able to continue to expand internally. What is perhaps equally important, since the Keynes Plan would tend to increase not only their imports but also their exports by enabling other countries to buy more of their goods with the aid of bancor, their trade deficit would tend to be lower than in the absence of the Keynes Plan. Nevertheless, it would be idle to deny that even under that Plan a stage is apt to be reached at which the expansion of internal trade becomes handicapped by lack of adequate means for purchasing essential goods abroad.

This consideration must be borne in mind in order to avoid unwarranted optimism about the effects of the Keynes Plan. It would be a mistake to imagine that the Keynes Plan would be able to eliminate altogether the conflict between the requirements of internal expansion and those of international trade and financial relations. There appears to be a widespread conception that, thanks to the Keynes Plan, it would become possible to import recklessly. This is by no means the case. Deficit countries must exercise the utmost care in using their bancor facilities, and should so far as possible confine themselves to importing essential goods. Otherwise a stage may be reached at which lack of adequate means to purchase abroad such goods would handicap further internal expansion

It is of the utmost importance to realise that if the Keynes Plan is applied in the wrong spirit it may become highly detrimental to internal monetary expansion. While one of the objects of the Plan is to ensure monetary stability, if this object is sought to be enforced too rigidly it is bound to frustrate the policy of monetary expansion. For if as a result of that policy the currency of a country becomes overvalued, the Governing Board of the Clearing Union might refuse permission for adjustment through devaluation. In that case, the export trade of the country concerned would be gravely handicapped and its resources for importing the goods required in connection wih internal expansion would become reduced. What is more, it is conceivable that the Government of the country might feel induced to adopt a deflationary policy to bring about the necessary adjustment to the world price level.

A wrong interpretation of the Keynes Plan might threaten internal monetary expansion also in a different way. Should the possibility of multilateral trade under the Plan be used for developing unplanned foreign trade on a large scale, it would gravely compromise the possibilities of internal planning, and since internal monetary expansion can only be undertaken safely under planned conditions, the result would then be that an expansionist policy would become too risky. This aspect of the problem will be dealt with more in detail in the next chapter. It is vital to realise that the Keynes Plan can only assist in internal expansion if it is interpreted in the right spirit, that is, if it is not used for enforcing an undue rigidity of exchanges or for restoring the anarchic state of foreign trade that existed in the past.

In addition to creating international purchasing power, the Keynes Plan pursues expansionist aims also by other means. The Governing Board has power to change the gold value of the bancor, and since the currencies of the participating countries are fixed in relation to bancor, any such change would mean an all-round devaluation of these currencies in terms of gold The result of such wholesale devaluation tends to be expansionary.

Another way in which the Governing Board can pursue an expansionary policy is by persuading the Governments of surplus countries to take measures for the expansion of their credit and purchasing power. The largest and most important surplus country, the United States, occupies such an important position in the world's monetary system that if she should adopt an expansionary monetary policy it would be bound to determine the world trend.

Strangely enough, the powers of the Governing Board to change the total bancor facilities from the amount originally fixed are limited It is entitled to reduce the quotas of all members in the same proportion and to restore them to their original level There is nothing in the Plan to suggest that the Governing Board has power to increase the quotas above their original level, except as a result of an expansion of foreign trade. The original quotas are to be fixed on the basis of the average foreign trade during the last three pre-war years, and should post-war trade exceed that average then an expansionary policy would be adopted automatically, since the quotas would be raised in proportion.

Before 1931, the adoption of the Keynes Plan would have meant that internal expansion would no longer have been handicapped by inadequate gold resources It would have amounted to an extension of the gold exchange standard under which foreign exchange as well as gold could serve as a basis for note circulation Since 1931, however, most countries have ceased to attempt to limit their note circulation according to the size of their gold and foreign exchange reserves. For this reason the application of the Keynes Plan will not make a material difference from this point of view

Monetary expansion can be overdone in the international as well as in the internal sphere. If expansionism simply consisted of increasing the volume of currency on the assumption that this necessarily means prosperity, then it is amazing that this simple device has not been adopted long ago. There is another name for such indiscriminate expansionist policy. It is inflation. History has many examples to show the disastrous effects of indiscriminate internal monetary expansion Nothing could be easier than resorting to the printing press and hoping for the best. It was done more than two hundred years ago under the expert advice of John Law in France; again during the French Revolution; during the American Civil War, and much more recently during and after the last war In all these instances the effect was decidedly destructive. Even during the present war monetary expansion in China, and to some extent in the Middle East, has produced a dangerous situation. On the other hand, in Great Britain and most other belligerent countries the inflationary effects of expansion have been kept under control. The explanation of this difference is that monetary expansionism can only be practised with impunity in countries which have succeeded in enforcing a high degree of economic discipline. It was utter lack of economic discipline which aggravated the consequences of monetary expansion in the historical instances quoted above. During the last war a fairly advanced degree of economic discipline was enforced in most countries, and inflation was kept in check. When, however, after the termination of the hostilities, economic discipline was relaxed, the result was advanced inflation.

Economic discipline is essential to ensure that currency should be expanded solely for the satisfaction of sound requirements. This is true not only for internal expansion, but also for international expansion. Indiscriminate expansion would soon lead to a breakdown of the scheme. One of the essential conditions of the success of the Keynes Plan is that foreign trade, which it aims at financing, should be planned in accordance with the general interest. If internal expansion leads to an orgy of spending and unplanned expansion of production, the effect is bound to be disastrous. If international expansion under the Keynes Plan leads to reckless luxury imports and the development of production catering for such imports, the collapse of the scheme is only a question of time. It is of the utmost importance that those responsible for the adoption of the Keynes Plan should not be inspired by the doctrine of expanding foreign trade at all costs for its own sake. About this aspect of the problem more will be said in the following chapter.

CHAPTER VII

MULTILATERAL TRADE

In his speech before the House of Lords on May 18th, 1943, Lord Keynes declared that the principal object of the Clearing Union Scheme could be explained in a single sentence: to provide that money earned by sellings goods to one country could be spent on purchasing the products of any other country. In jargon, this is the system of multilateral clearing; in English, a universal currency valid for trade transactions all over the world.

Before the last war every country was able to import and export freely without having to concern itself with balancing its trade in relation to any particular country. It was able to sell the foreign exchange obtained for its exports and obtain any other currency it needed. There was no difficulty in spending the proceeds of its exports in any country. This does not mean that ideal conditions of free trade existed. Even before the last war most countries had protective tariffs against imports. The object of these tariffs was not to safeguard the national currency against an adverse trade balance, but either to produce revenue or to safeguard home production against foreign competition. The trade balance was left to take care of itself. Usually the countries with a series of adverse trade balances were able to secure international loans to meet their deficits. It was only after the last war that countries began to impose restrictions on their imports in order to safeguard their currencies. Foreign loans were no longer forthcoming as easily and regularly as before the last war. After the Wall Street slump, foreign lending virtually ceased, and deficit countries began to view the prospects of their currencies with growing concern. They had to make sure to be able to balance their imports with the aid of their exports. The only way in which this could be done was through forcing each country whose goods they purchased to purchase their goods in exchange. They no longer dared to trust to luck that in the long run everything would turn out for the best and that sooner or later the money they spent on foreign goods would come back in the form of foreign purchases. For one thing they did not possess any money to spend on foreign goods unless foreign exporters immediately spent on national goods the proceeds of their exports. Such small gold or foreign exchange reserves as they possessed they wanted to retain for extreme emergencies. Hence the tendency towards bilateral trade and exchange arrangements.

From 1931 onwards scores of bilateral clearing and other international payment arrangements were concluded, under which exporters were unable to obtain payment unless they or their fellow nationals purchased the goods of the debtor country. This led to a tendency towards a contraction of world trade For the first time in modern history many countries decided to limit their exports because they were unable to use the goods of the importing countries. In the olden days it would not have mattered, for if they had no use for the goods of their customers they were always in a position to spend in a third country the money obtained for their exports. Under the new system, however, they had to choose between buying unwanted goods or accumulating frozen claims. It is no wonder that in many instances Governments preferred to curtail exports.

Efforts were made to remedy this state of affairs by resorting to triangular and multilateral exchange clearing. In a number of instances before the war arrangements were made to offset the deficit of one country against its surplus in relation to another country. Thus, if Country A had an export surplus in relation to Country B, Country B had an export surplus in relation to Country C, and Country C had an export surplus in relation to Country A, an agreement between the three countries made it possible to clear these surpluses against each other Unfortunately, such arrangements remained the exception and not the rule. It was hoped that sooner or later the multilateral exchange clearing system would be adopted, under which it would become much easier to clear surpluses and deficits against each other. This solution was attempted by Germany after the conquest of the greater part of Europe The establishment of a multilateral clearing system formed an essential point of Hitler's scheme for a "new economic order" in Europe. In practice, the experiment was, however, an almost complete failure. This was due in part to the essentially one-sided trend of foreign trade in German-controlled Europe As a result of the exploitation by Germany of conquered countries and satellites alike, her trade in relation to all these countries showed a persistent import surplus. And since all countries had frozen reichsmark clearing balances to offer they were unable to find a country which needed such balances. This in itself would have been sufficient to frustrate the efforts at multilateral clearing. Because the Governments concerned were far from certain whether they would be able to dispose of their credit balances arising from their bilateral clearing agreements, they preferred to accumulate no such credit balances. In many instances the Governments of German-controlled Europe preferred to reduce their exports rather than accept frozen balances in payment. In relation to Germany, they simply had to obey orders and export to the limit of their capacity In relation to other satellite or conquered countries, however, they endeavoured to balance their trade, just as if the much-advertised Multilateral Clearing Institute of Berlin did not exist.

Discouraged by the European experience, Lord Keynes did not base his scheme on a multiplicity of bilateral trade agreements. Instead he employed a device under which he sought to restore the confidence of financially weak countries in their ability to pay for their imports. Before 1914 there was no need for bilateral agreements because of the prevailing optimism that under a régime of free trade imports are bound to be balanced by exports. Needless to say, even during the happy if dull years of the nineteenth century this was not altogether true. From time to time debtor countries had to default on their international liabilities. Nevertheless, the conception that under a régime of *laissez faire* everything was bound to turn out for the best was deeply rooted in the minds of economists, Governments and peoples. The events that followed the last war destroyed this faith in the miraculous effect of *laissez faire*. It would be no easy task to try to restore it. Lord Keynes did not even attempt to do so, even though he did make an effort to fight prevailing pessimism. "We are too ready indeed to assume the inevitability of unbalanced trade positions," the Report states, "thus making the opposite error to those who assumed the tendency of exports and imports to equality. It used to be supposed, without sufficient reason, that effective demand is always properly adjusted throughout the world; we now tend to assume equally without sufficient reason that it never can be"

Lord Keynes devised a very practical means for restoring that optimism that is a preliminary condition of multilateral trade His scheme provides deficit countries with the means to pay for their deficit They need not hesitate any longer to run up a favourable trade balance in relation to any particular country, since they know that the country in question will settle its import surplus with the aid of bancor. This should enable them in turn, to meet their deficit in relation to other countries which are willing to accept bancor. The facilities provided by the Clearing Union have been fixed at a very substantial figure, precisely in order that their existence should inspire an adequate degree of confidence; 75 per cent. of the total of the pre-war imports and exports of any country should normally be sufficient to cover its trade deficit for some years. Assuming that the first onrush of relief shipments and other abnormal imports after the war will be financed outside the scheme, there should be every reason to trust even the weakest countries to be able to pay for their normal import surplus with the aid of bancor for some time to come.

In theory multilateral clearing should be able to accomplish a good deal even in the absence of credit facilities such as are provided under the Keynes Plan It should be possible to clear surpluses and deficits in a large number of instances, and only the net surplus or deficit would present difficulty. In practice, however, this fear of difficulties caused by net surpluses would effectively prevent multilateral clearing unless the means are provided for settling the net deficits There is a widespread conception which was shared by Sir Kingsley Wood—that the object of the Keynes Plan is to restore multilateral trade such as had operated before the last war. Whether Lord Keynes envisaged this or not is not clear from the text of the Plan. Most commentators emphasised that in itself the Plan does not solve the problem of foreign trade unless accompanied by the removal of all kinds of trade barriers In reality, its sole task is to remove the handicap of foreign trade due to the foreign exchange position

The question is, would it be wise to aim at restoring unplanned free trade with the aid of the Keynes Plan? Those brought up in the orthodox school may be shocked at the very thought of questioning the wisdom of any suggestion for stimulating world trade which they consider an unmitigated blessing In reality, it would be dangerous to adopt such a dogmatic view While the freezing of world trade during the 'thirties caused much harm, it is open to argument whether an indiscriminate unfreezing would not be the cause of much evil of a different kind

Free trade after the war would mean complete freedom for all Governments to spend the resources of their countries on luxury imports If the Government of a poor country is controlled by a corrupt ruling class which, being anxious to make up for the lean time they had under German occupation, induces the Government to agree to import millions of pounds worth of champagne and caviar, the facilities allotted to that country under the Keynes Plan would soon come to an end Before very long there would be no exchange available for the imports required by the urgent tasks of reconstruction The unfreezing of trade might mean an orgy of luxury spending by those who could least afford it. What is much worse, it is certain to mean a reckless scramble for raw materials and manufactures, the supplies of which have become exhausted during the war In the absence of the Keynes Plan the countries which succeeded in preserving or even increasing their gold or foreign exchange resources would be able to buy up all the limited stocks available and would leave the poorer countries without essential materials. The Keynes Plan would give an equal chance to all, during the immediate post-war period at any rate. If, however, all beneficiaries under the Keynes Plan began to compete recklessly in the world markets, then prices would be driven sky-high and supplies would soon be exhausted.

That it will be essential to subject foreign trade to control according to some agreed international plan for some time after the war must be obvious to everybody. If individual initiative should be let loose, then many countries would eventually be gravely handicapped in their reconstruction work and would have to continue to suffer privations. The Keynes Plan must not mean, therefore, the return to uncontrolled free competition for goods. As far as the early post-war period is concerned, bilateralism would be preferable to such a wild scramble, since under bilateralism trade is at any rate subject to planning. None but the most extreme dogmatists would advocate the use of the Keynes Plan for the immediate return of uncontrolled multilateral trade without any attempt at rationing inadequate supplies to satisfy the most urgent needs

The question is whether in the long run it would be to the advantage of mankind to return to uncontrolled free trade. After a number of years the scarcity of supplies in most commodities would come to an end, and there would be no longer any need for rationing purchasers On the other hand, from the point of view of the planning of internal trade it will remain necessary to subject foreign trade to some form of planning. Otherwise the uncontrolled use of the huge volume of additional international purchasing power created under the Keynes Plan would threaten to upset internal planning There would be nothing to prevent the majority of participants in the Keynes Plan from exercising their purchasing power in one particular country at the same time. This would mean that the country concerned would be deprived of much of its supplies needed for its own requirements or that, in the absence of price-control, the price-level would be driven up It is inconceivable to plan successfully if a country is exposed to such a sudden drain on its supplies or if it is exposed to large supplies being unexpectedly dumped on its markets. If production is planned according to the estimated requirements of the population, the calculations might easily be upset by the sudden import of vast quantities of certain goods, the requirements of which are already covered by home production.

We went out of our way to point out in the previous chapter that monetary expansion was apt to lead to disaster unless accompanied by planning and economic discipline. The same is true also of monetary expansionism in the international sphere. It would be comparatively easy to bring about a considerable increase in the volume of world trade with the aid of a return to the multilateral system. Unless, however, this effort were accompanied by planning and the application of economic discipline over the international sphere, the result would be anything but gratifying.

It cannot be emphasised sufficiently that foreign trade is not wanted for its own sake, but solely for the sake of such benefits as it may confer on mankind, and only to the extent to which it does confer benefits. According to the orthodox conception, the more goods are exchanged across the frontiers the better for all concerned. It fills the hearts of orthodox economists with joy to see a country importing blue buttons and exporting green buttons, or even importing as well as exporting green buttons. Yet it is difficult to see how any such traffic can contribute towards the general welfare All it does is to increase the range of choice for purchasers without in any way increasing their standard of living. While it may give a certain amount of satisfaction to many people to be able to buy something different from what their friends have, the satisfaction thus obtained is dearly paid for if it means the upsetting of calculations essential for planned production. Under bilateral agreements the country knows more or less how it stands, because the quantity of imports is to some extent regulated. Under multilateral trade, however, anything might happen anywhere, and the authorities in charge of planning would be incapable of making reliable estimates of our requirements to be covered by home production

All this is pointed out not as an argument against the Keynes Plan but as a warning against the adoption of the Keynes Plan without simultaneous arrangements for planned foreign trade. The world cannot afford to create vast purchasing power and trust to luck that it would be used to the best advantage of mankind. Safeguards that the new facilities should be used wisely are essential Without them the Keynes Plan is apt to do more harm than good, for no advantage that can possibly be gained from it would compensate the participants for the loss of the advantages they stand to gain by planning their internal economies.

It may be objected: "What is the use of the Keynes plan if in spite of the facilities it provides for the restoration of multilateral trade it cannot obviate the necessity for putting international trade in a straight-jacket?" The answer is simple. In the absence of the Keynes Plan, Government interference with the flow of international trade is often dictated by considerations arising from the foreign exchange position Thanks to the Keynes Plan it would be possible to plan world trade in accordance with fundamental economic interests

In the absence of the facilities provided by the Keynes Plan the country may have to import goods it does not really require as the only means by which it can receive payment for its exports On the basis of the Keynes Plan this would not be necessary While foreign trade may still be diverted into what purists describe as "unnatural channels," this would be done not for the sake of the foreign exchange position but for the sake of major economic interests such as the necessity of international rationing of some material the supply of which is inadequate. Thus Government intervention under the Keynes Plan would serve a higher purpose than it did in the past.

CHAPTER VIII

STABILITY *v.* ELASTICITY

THE publication of the British and American currency plans created a controversy between those who believe in maintaining stability of exchange rates at all costs and their opponents who advocate elastic exchange rates This controversy is of comparatively recent origin. Before the last war it did not exist at all Practically everybody unquestioningly assumed that stable exchange rates were a vital necessity for the welfare of mankind. It was not until after the last war that the wisdom of this assumption came to be questioned Professor Irving Fisher put forward his scheme of a commodity dollar under which the gold value of the dollar should be changed in order that its commodity value should remain stable. The various schools of monetary expansionists, too, came to realise the difficulty of maintaining the external stability of the national currency if their scheme of internal expansion were adopted

For a long time their contention that it would be worth while to sacrifice the stability of the exchanges for the sake of the advantages derived from monetary expansion was given little or no attention in official circles The latter became eventually converted in many countries in favour of elastic exchanges on totally different grounds By 1931 it became obvious that if an exchange is overvalued compared with its internal purchasing power (that is, if on the basis of the prevailing parity the internal price level is above world level), then its defence may prove to be too costly and even impossible. Accordingly, a large number of countries abandoned the policy of rigidly maintaining the stability of their currencies in relation to gold Between 1931 and 1939 most of the leading exchanges were, in fact, in a state flux Their adjustment by official action was determined for the most part by purely practical considerations There was no attempt at maintaining the stability of sterling in terms of commodities or to adjust its exchange value in order to correct any unwanted tendencies in the British price level; nor did the British foreign exchange policy aim at maintaining sterling in the vicinity of its purchasing power parities. The officially declared policy was to iron out minor fluctuations and resist comparatively weak or passing tendencies, while yielding to major pressure, whether it was due to a deviation of sterling from its purchasing power parities or to major capital movements caused by political or economic factors

The foreign exchange policy of other countries which departed from the policy of rigid stability of their currencies in relation to gold was also guided by essentially practical considerations. There was little scientific about their policy, and it serves no useful purpose to try to read into it motives and guiding principles which did not influence those responsible for the monetary management of the countries concerned.

It is only the first step that is difficult, and once the Governments concerned abandoned the policy of rigid stability they were inclined to fall into the other extreme Having realised the grave disadvantages of holding the currency at an overvalued level, they wanted to be on the safe side and aimed at deliberately undervaluing their currencies. The result was a competitive currency depreciation race. In 1933, the dollar was devalued to an unnecessary extent in order to ensure that it should be undervalued rather than overvalued in relation to sterling. The object of the competitive currency depreciation race was to secure advantages for exporters by enabling them to undersell their foreign competitors with the aid of a depreciated national currency.

The main disadvantage of a currency depreciation race is that it tends to unsettle international financial conditions and also internal economic conditions. Major changes in the exchange value of any important currency are bound to produce worldwide repercussions. If such changes occur too frequently it is bound to be detrimental both to foreign trade and to domestic production The realisation of this gave rise to a strong and widespread desire for some arrangement under which such changes in exchange parities as are inevitable should be made by agreement with the foreign countries whose international and internal situation stands to be affected. In 1936, the United States, Great Britain and France concluded the Tripartite Currency Pact, under which they agreed to refrain from competitive depreciation. They undertook not to make any more major alterations of their exchange rates without consulting their partners in the agreement. The Tripartite Agreement did not, however, produce satisfactory results, owing to the rigidity with which the United States opposed any devaluation of sterling, and both the United States and Great Britain opposed the devaluation of the franc, however justified such devaluations appeared to be from the point of view of the fundamental economic and financial situation.

The war led to a temporary suspension of the controversy between the adherents of currency stability and elasticity, for the simple reason that for the duration all exchange rates have been rigidly pegged. With the increase of interest in peace problems, however, the question became once more subject to a certain amount of discussion during the past year or so. The adherents of both schools were anxious to register their demand for a post-war solution on the lines they advocated

The Keynes Plant constitutes an attempt at a compromise between the two opposite schools. It seeks to combine the advantages of stability with those of elasticity Lord Keynes is known to have been in sympathy with the idea of the commodity pound, the gold value of which should be subject to adjustments in order that its commodity value should be kept stable. He had, however, enough practical sense to realise that such a solution would be entirely unacceptable to the United States. Accordingly, the scheme submitted to the Treasury by Professor Hayek for the creation of an international currency unit called "commod," based on the index number of the principal commodities, was rejected. The Keynes Plan is based on the principle that gold must remain the standard of value In order to get the best of both worlds, another plan has been elaborated independently of the Clearing Union scheme, under which an international organisation should be set up to maintain the stability of the prices of the principal commodities. Should that scheme succeed, sterling would be kept reasonably stable in terms of commodities at the same time as being kept stable in terms of gold

A lifelong opponent of the gold standard, Lord Keynes has possibly saved that system by elaborating a solution under which its advantages can be retained while its main disadvantages can be eliminated. Many monetary experts, including probably Lord Keynes himself, would object to the suggestion that the system proposed by the British Currency Scheme could rightfully be described as a form of gold standard. It all depends, of course, on our definition of the meaning of the gold standard. Before 1914, gold standard meant free convertibility of the national currency into gold coins or bullion. After the last war its meaning became modified as most countries ceased to convert their currencies into gold coins, while retaining their convertibility into bar gold. Other countries confined themselves to maintaining the convertibility of their currencies into a foreign exchange based on gold. These systems were described as gold bullion standard and gold exchange standard respectively, but considering that under them the national currency was rigidly fixed in terms of gold, they may be safely regarded as peculiar forms of the system of the gold standard.

After 1931, the meaning of the gold standard underwent further modification. A number of countries, Great Britain amongst them, ceased to convert their currencies into gold or into foreign exchange at a fixed rate Nevertheless, they used gold for the purpose of the settlement of their international balances of payments After a period of fluctuation of their exchanges the policy was adopted to maintain them reasonably stable in relation to gold, even though the rigid stability prevailing before 1931 was not restored Nevertheless, considering that gold was used both as a means to settle international balances and as a standard of value, even this system may be described as a form of elastic gold standard

Under the Keynes Plan, gold is meant to retain a very important role in the international monetary system The Clearing Union would be under obligation to buy at a fixed price any gold offered to it for sale by Governments or Central Banks. As a result, gold could not depreciate below the price fixed by the Clearing Union At the same time, the participating Governments have to undertake not to pay for gold higher prices than those corresponding to the Clearing Union's buying price. This in itself would not necessarily prevent the appreciation of gold above that buying price, since there is nothing to prevent non-member countries from paying higher prices, and private interests in member countries also would be in a position to bid up the price of gold in the free market. Nevertheless, it seems safe to assume that in practice the price fixed by the Clearing Union will be effective in both ways.

The Keynes Plan leaves it to the Governments of the participating countries to decide whether to fix a buying and selling price for gold in terms of their respective national currencies The bancor is fixed in terms of gold and the currencies of member countries are fixed in terms of bancor, and therefore for all practical purposes they are indirectly fixed in terms of gold Whether the Central Banks are under obligation to buy or sell gold at the parity thus fixed is for the Governments to decide.

The original bancor value of the national currencies is to be fixed by agreement In practice, this will mean that if a Government should insist on an unreasonable parity then it will not be admitted into the Clearing Union unless and until it agrees to accept the parity which is considered reasonable by the majority of participants The question is whether the parities once fixed will be liable to modification in accordance with changing requirements From this point of view the school favouring stability scored a victory in the British Currency Plan, since the general rule will be that there can be no modification in parities without the consent of the Governing Board While before the war any Government was in a position to take unilateral decision to devalue its currency, under the Keynes Plan its decision will have to be submitted for approval to an international body This arrangement goes much further than the Tripartite Currency Pact of 1936, because that arrangement was largely informal and could have been terminated at short notice. Consequently, when France insisted on repeated occasions that notwithstanding American and British opposition she must devalue the franc, Washington and London reluctantly agreed as an alternative to the breaking up of the Tripartite Agreement

Under the Keynes Plan, on the other hand, a country which wants to alter the exchange value of its currency in spite of opposition on the part of the Governing Board cannot withdraw from the arrangement without giving twelve months' notice. Moreover, its withdrawal would not endanger the existence of the scheme, and there would not be the same inducement for the opponents of the devaluation to yield rather than risk the withdrawal of the country concerned as there was before the war in the case of the Tripartite Pact.

The victory of the adherents of stability was not complete, however. There are several provisions in the Keynes Plan which constitute concessions to the policy of elasticity. In the first place, during the first five years of the operation of the plan, special consideration would be given to requests for changes in the parities. This is only natural, since it will be impossible to ascertain at the time of the termination of hostilities the parities that correspond to post-war conditions in the countries concerned. What is perhaps more important, any country is entitled to devalue its currency to the extent of 5 per cent if its average overdraft with the Clearing Union exceeds 25 per cent. of its quota over a period of two years The Governing Board of the Clearing Union in turn is entitled to compel member countries of the Clearing Union to devalue their currencies if their overdraft has reached 50 per cent. of their quotas. The Governing Board can also advise countries with large bancor credit balances to raise the exchange value of their currencies for the purpose of facilitating the liquidation of their credit balances. Finally, the right to withdraw at twelve months' notice if the Governing Board's decision is considered unsatisfactory also constitutes a concession in favour of elasticity, at any rate in theory.

All these provisions have failed to satisfy the adherents of elasticity. They are of the opinion that under the Keynes Plan sterling would be tied to gold and to the dollar. There can be no doubt that the United States would be opposed to any devaluation of sterling as she was opposed to it under the Tripartite Pact before the war. And Great Britain would find it even more difficult to disregard its opposition than she did before the war. The United States would have no difficulty in securing the required majority of votes to veto the devaluation of sterling, even if such devaluation were justified by the existing state of disequilibrium. In theory the remedy lies in the hands of the British Government since it would be in a position to withdraw from the scheme on giving twelve months' notice In practice, however, such a decision would encounter almost insurmountable difficulties For one thing, a country relinquishing its membership would forgo its very considerable economic advantages. What is even more important is that a British withdrawal would have far-reaching political consequences It would be opposed on the ground that it would amount to the discontinuation of economic and even political collaboration with the United States. In the circumstances, the British Government would be inclined to put up with grave disadvantages arising from the overvaluation of sterling before it would feel compelled to decide to withdraw from the Clearing Union irrespective of consequences. Thus, whatever the legal position may be, in practice withdrawal would be unlikely.

Government spokesmen went out of their way during the debate on the Keynes Plan in both Houses of Parliament to emphasise that by agreeing to submit to the Government Board its decision to devalue sterling the Government would not relinquish its soverign right to determine the value of sterling They supported their contention with the argument that after all in any commercial treaty the Government would undertake to refrain from taking various actions which a sovereign nation is entitled to take. There is, however, a considerable difference between any commercial treaty and the Clearing Union Scheme. The extent to which even the most important commercial treaty is liable to affect the vital interests of the nation is small compared with the extent to which vital interests are affected by the value of the national currency. Past experience has conclusively proved that under given circumstances the overvaluation of national currency leads to deflation, unemployment, financial crises, political instability, and might even endanger the nation's security and independence It is, therefore, reasonable to object to submitting to an international body the decision to modify the value of the national currency. If we could be certain that the Governing Board would consist of impartial experts who would decide according to the merits of the case and would not allow themselves to be influenced by their respective national interests, then there would be no danger in placing decisions in their hands Unfortunately, past experience does not justify such an optimistic assumption. It is obvious that the main reason why the United States wants to participate in any international currency scheme is to prevent the undervaluation of sterling at all costs In such circumstances, the acceptance of the Keynes Plan in its present form would necessarily mean in practice if not in theory that sterling would be tied to the dollar Even if under extreme pressure through a sweeping economic crisis due to an overvaluation of sterling the Government should decide to withdraw from the Clearing Union, it would take twelve months before this decision would become operative, and meanwhile the nation would have to continue to suffer all the evil consequences of an overvalued exchange

In these circumstances it would appear advisable to insist that the Keynes Plan should be modified and that the participating Governments should retain their freedom to change the parities of their currencies after consulting with the Governing Board Alternatively they should recover their freedom of action immediately on giving notice of withdrawal from the Union Or else, a set of definite rules should be elaborated to determine the conditions in which the Governing Board would not be entitled to withhold its approval of a proposed change in the value of the national currencies of member countries An index should be worked out under international supervision, and if that index shows a certain degree of disequilibrium the Governing Board should be under obligation to give its consent to make the necessary changes in the parities Under the Keynes Plan the only index is the amount of the bancor overdraft of the participating countries. It would take two years before, on the basis of that index, a country would be entitled to devalue its currency to the extent of 5 per cent It may well be that such a devaluation would then be too late and not sufficient If the overdraft of participating countries exceeded 50 per cent , then the Governing Board would be entitled to require the countries concerned to devalue their currencies, but the decision in this respect would depend on the Governing Board and would not automatically follow from the increase of the overdraft In any case, the size of the adverse trade balance does not in itself indicate the existence or degree of a disequilibrium that could and should be corrected by means of a devaluation The index on which the decision to devalue should be made dependent should be based on relative price levels rather than on the size of the overdraft.

If the United States should make her participation in the scheme conditional on Great Britain's willingness to submit the decision to devalue the pound to the approval of the Governing Board, then it is doubtful whether it would be worth our while to proceed with the scheme at all Should the Government decide to take the immense risk of linking sterling rigidly to the dollar, it must provide for adequate safeguards against the consequences of its decision. The United States Government will have to make many concessions to make it worth our while to take the risk.

It is also important to realise the internal implications of the decision to link sterling with the dollar. The consequences of the decision depend largely on the internal monetary and economic policy pursued. The experience of Germany between 1933-1939 proves that an expansionary monetary policy is not incompatible with stabilised exchange rates, provided that all-round measures of financial and economic control are maintained In the first place, exchange restrictions would have to be maintained in order to prevent the flight of capital that invariably accompanies an overvaluation of a currency. In the second place, price control would have to remain in order to moderate the degree of the overvaluation of the currency The alternative method of defending sterling linked to the dollar would be to put up the bank rate, thus enforcing disastrous deflation leading to wholesale unemployment

It is outside the scope of this book to deal with the broad aspects of economic control *versus* monetary orthodoxy What is essential is that everybody should realise what is at stake. If this country should agree to link sterling to the dollar under the Keynes Plan, or under any other international currency plan, then it is confronted with the choice between having to defend sterling either through deflation at the cost of unemployment, or through the perpetuation of exchange control, price control and other drastic measures of Government intervention Opinions may differ whether the advantages derived from the currency Plan would be sufficient to make it worth while to choose either of the two solutions What matters is that everybody should realise the cost this country would have to pay for those advantages in accepting the American terms regarding the stability of sterling

There is yet another consideration to be borne in mind. Whether or not the stabilisation of currencies under the Keynes Plan would prove to be too rigid depends largely on the initial parities to be agreed upon. Should the United States insist on an overvaluation of sterling in relation to the dollar, then the system would soon prove intolerably rigid and would break down. If, on the other hand, the United States should take a liberal view—she can well afford to do so—and agree to fix a sterling-dollar parity which would allow for Great Britain's difficulties, then the system would be able to start with a good chance of surviving at least the first few critical years.

Finally, the importance of the question of rigidity *v* elasticity could be reduced considerably with the aid of planning world trade on an international scale This subject was already touched upon in the last chapter, when we argued that the Keynes Plan should not be used for the restoration of the old system of unplanned multilateral trade One of the arguments in favour of planning world trade under the Keynes Plan is that it would obviate, or at any rate mitigate, the necessity for competitive currency depreciation In any case, most experts have realised by now that depreciation of a currency for the sake of stimulating exports is foolish and short-sighted, because it merely amounts to giving away more of our goods in exchange for the same amount of foreign goods. Nevertheless, if a country is unable to procure the foreign exchange needed for vital imports, then it may have to resort to this foolish method under a system of international trade based on free competition. If, on the other hand, foreign trade is planned through the allocation of markets, then the inducement for depreciating the national currency for the sake of being able to export would lessen considerably.

CHAPTER IX

BALANCING FOREIGN TRADE

ONE of the greatest difficulties during the period between the two wars was the essentially one-sided character of world trade. As a general rule the rich countries were growing richer and the poor countries growing poorer. On the one hand the United States and a small number of creditor countries were piling surplus on surplus. They were unable or unwilling to take goods in exchange for a very large proportion of their exports. As a result their gold stocks and their claims against deficit countries were increasing year after year at an abnormal pace. On the other hand, deficit countries failed to make a real effort to check the growth of their international indebtedness. Indeed, they were borrowing most recklessly, and not always for constructive purposes. While in the nineteenth century the process of the growth of international indebtedness was gradual, after the last war it was crammed into the brief space of a decade. What is worse, while during the nineteenth century the countries with export surpluses were steady lenders, after the last war the United States was most erratic in its foreign lending. For a while she was lending lavishly. The hotels of Central Europe and Latin-American capitals were crowded with representatives of American bond-selling houses literally throwing money after potential borrowers, and competing with each other for the favour of their custom. All this came to an end suddenly after the Wall Street slump of 1929, from which time foreign lending by the United States virtually ceased.

No currency would be able to stand the strain caused by such sudden changes in tendencies. If world trade should resume its unilateral trend after the war, and if the surplus is not consolidated by regular foreign lending, then the facilities created under the Keynes Plan would soon become exhausted and the world would be no better off than it would have been without the scheme. One of the essential conditions of the success of the Keynes Plan is therefore to achieve a reasonably well-balanced world trade or, alternatively, to ensure that surpluses which cannot be liquidated should become consolidated with the aid of constructive long-term investments

When discussing the problem of how to deal with surpluses we inevitably have the United States in mind, since it is obvious that for many years after the war she will tend to have a large export surplus. The problem that her surplus will present will be even more difficult to solve than it was before the war, for the monetary gold stocks of the world are now almost entirely in American hands, and the extent to which the deficit countries would be able to pay for import surpluses by gold shipments will be smaller than it was before the war Moreover, the productive capacity of deficit countries is bound to remain low for some years, and they would be unable to pay for their imports of American goods by means of exports to the United States, even if the latter country showed more readiness to buy their goods than it did before the war.

As a matter of fact there is no indication whatsoever that American public opinion has learnt anything from the pre-war experience. Official circles in the United States are only too well aware that, unless the United States is prepared to accept payment in goods, or to re-lend the surplus, she will simply be unable to continue to export to the extent she wishes to. The American public, however, still persists in its inconsistent attitude of wanting to export without giving foreign importers a chance to pay for their purchases. When some years before the war the late Lord Stamp was lecturing to an American audience he tried to explain that if the United States wanted to maintain her exports she would have to accept payment in goods or else her gold reserves would increase further whether she liked it or not One of the audience remarked, " We are not concerned with all that, all we want is to be paid in dollars " Unfortunately, there is no reason for hoping that there is to-day more understanding in the United States of the true implications of the problem than there was in those days. Indeed, there is already a fair amount of agitation caused by the Keynes

Plan precisely on the ground that it would force the United States to accept goods in payment for her exports. Even economists who ought to know better take that line.

There are admittedly some Americans who are sufficiently enlightened to see the necessity for aiming at balancing American trade. Most advanced among them is Mr. Herbert Feis, with whose proposal to cancel any unused credit balances after two years we dealt briefly in an earlier chapter. The Keynes Plan casually mentions the possibility of resorting to that solution, but rightly refrains from suggesting it. Any suggestion involving sacrifice on the part of creditors must come from the United States. Even as it is, anti-British propaganda in that country accuses the Keynes Plan of aiming at reducing the United States to the rôle of the milch cow. It is easy to imagine the outburst that any British suggestion that unused bancor balances should be cancelled after a while would provoke in the American Press. To avoid giving opportunity for such attacks, the Keynes Plan errs if anything on the side of excessive timidity in dealing with the problem of preventing the accumulation of unduly large bancor balances on the accounts of the surplus countries

The provisions of the Plan include a clause under which a member State would have to pay to the Clearing Union a charge of 1 per cent. per annum on the amount of its average debit or credit balance in excess of a quarter of its quota; and a charge of 2 per cent. in excess of a half of its quota The Report hastens to add, however, that these charges are not absolutely essential to the scheme. Evidently its authors were afraid that the idea of having to pay 1 or 2 per cent on bancor balances would meet with strong objections in the United States. Yet this idea is not altogether new. During the 'thirties Swiss and American banks sought to discourage an influx of unwanted refugee money for which they had no profitable use, by charging a commission on new accounts and on additional sums received on old accounts, instead of allowing interest as before. The theoretical foundation of the proposal can be traced to the monetary reform scheme put forward by Silvio Gessell after the last war, according to which, in order to speed up the spending of money, a negative interest should be charged on bank notes in the form of a stamp to be affixed weekly or monthly. The idea was that, in order to avoid having to pay this interest, the public would spend more freely during a period when inadequate spending was causing wholesale unemployment. This plan was endorsed by Lord Keynes in his *Treatise on Money,* and he has now applied it in the international sphere. The assumption is that in order to avoid having to pay negative interest on their bancor balances, the surplus countries would endeavour to spend that surplus on goods, or to relend it in the form of long-term investments, in which case they would receive interest instead of paying. While the principle is undoubtedly sound, it would be a mistake to over-rate the actual effect of this measure. The percentage of the charge would have to be much higher in order that it should act as a real deterrent tending to discourage the accumulation of bancor balances.

Another way in which the Keynes Plan makes a timid attempt to induce creditor countries to liquidate their bancor balances is embodied in the provision that a member State whose credit balance has exceeded half of its quota on the average of at least a year shall discuss with the Governing Board what measures would be appropriate to restore the equilibrium of its international balance. The Report emphasises, however, that the creditor country shall retain the ultimate decision in its own hands; while the Governing Board has the power to direct debtor countries to take certain steps to balance their trade, it can only make suggestions to creditor countries. The Report contains a list of the admissable suggestions which includes (*a*) measures for the expansion of domestic credit and domestic demand; (*b*) the appreciation of the creditor's currency in terms of bancor; (*c*) the reduction of tariffs and of other measures against imports, and (*d*) international development loans. While it is conceivable that a small creditor country might heed the advice of the Governing Board in these matters, it is difficult to imagine the United States allowing her fundamental economic and monetary policy to be influenced by the suggestions of an international body. Nevertheless, the mere idea that such suggestions should be made and that interest should be charged on bancor balances may produce a salutary effect in that it may make the American public realise that unbalanced world trade is the joint responsibility of creditors and debtors. In the past it was always the debtor countries who had to put up with lecturing and advice about balancing their foreign trade by cutting down their imports or increasing their exports. In future, creditor countries, too, would be told at any rate that they should export less or import more.

A practical way in which the Clearing Union would be in a position to reduce bancor balances would be through the distribution of its gold stocks among holders of such balances in proportion to their holdings. If this process is resorted to frequently, however, then the advantage of the inconvertibility of the bancor would disappear. Creditor countries would then have no inducement to accept goods in payment, or to grant long-term loans, unless they did not wish to receive any more gold. It is far better if the surplus countries are not in a position to rely on their bancor balances being eventually reduced through a distribution of gold. Then they have to do a little hard thinking how to reduce these balances by purchasing goods or by granting long-term loans. One of the advantages of the Keynes Plan is that by restoring multilateralism it would enable creditor countries to spend their surpluses anywhere instead of having to buy the goods of their debtors, goods for which they may have no use. The Keynes Plan expressly rules out any restriction on the disposal of receipts arising out of current trade or invisible income In the case of the United States this arrangement would not affect the position to any marked extent, for, being in possession of a vast gold reserve, she is able to buy goods wherever she likes. If the system proposed under the Keynes Plan had been in operation before the war, however, many poorer countries would not have become unwilling holders of credit balances in various frozen currencies.

The Keynes Plan mainly concentrates on an effort to induce the surplus countries to spend their surplus through increasing their purchases. It deals somewhat casually with the problem of consolidating through long-term investment the unspent and unspendable surplus. It rightly regards this problem as outside the scope of the Plan, and suggests that another Plan should be elaborated for the creation of an International Investment Board.

As we have seen above, the proposals of the Keynes Plan to induce creditor countries to liquidate their bancor balances are by no means drastic. The authors of the Plan are naturally anxious to avoid antagonising the United States and creditor countries in general. Nor do they wish to place a limit on the amount of bancor that a country is entitled to accumulate. A provision under which a creditor country would not be required to accept bancor in excess of a prescribed figure might impair the general acceptability of bancor without solving the problem of one-sided world trade If the surplus country should choose to put a limit to its holding, it could do so either by simply restricting its exports or by adopting some kind of bilateral agreement outside the Clearing Union. All that could be done even in the absence of the Clearing Union. As the Keynes Plan rightly remarks, the advantage of the plan is exactly that it leaves to the creditor country to choose whether to limit its exports or avoid limiting them by taking advantage of the facilities provided by the Plan The existence of the Plan does not preclude any restrictions on exports, but it enables a surplus country which does not wish to restrict its exports to avoid that course.

The measures taken under the Keynes Plan in order to prevent or discourage the accumulation of big credit balances should, of course, go a long way towards moderating the accumulation of debit balances, since the counterpart of each credit balance is necessarily a debit balance. On the other hand, the very existence of special credit facilities for the benefit of deficit countries tends to encourage the creation of debit balances. In the ordinary course it would be necessary for deficit countries to negotiate loans or credits abroad, which is by no means simple. Under the Keynes Plan they would be in a position to draw on facilities placed at their disposal as part of the scheme. The ease with which these credit facilities would become accessible and could be utilised up to a point would in itself be liable to encourage the creation of debit balances. This is, of course, inevitable, since the whole fundamental idea of the scheme is to provide the means for weak countries to finance their import surpluses. It is to be hoped, however, that the authors of the scheme or the Governments which would eventually be responsible for its adoption will make it quite plain that the development of import surpluses is at best to be regarded as a deplorable necessity, and not an object to be aimed at It would be most harmful if we were to resort to the nineteenth century conception under which it was believed that there could be no harm in import surpluses since they necessarily give rise to corresponding export surpluses in the long run to enable debtor countries to discharge their debts. Translated into terms of private economy, this would amount to saying that it is a good thing if we run up overdrafts since the mere fact that we owe money to the bank should enable us to earn more in order to pay off our indebtedness. The absurdity of such a suggestion is quite obvious when dealing with individual economies, and yet an entire scientific school of thought was built on the same conception as applied to national economies. Fortunately, that conception has now been all but universally discarded So much so that Lord Keynes considered it necessary to warn against falling into the opposite extreme by assuming that import surpluses can never be repaid by a corresponding increase of exports. While this warning was salutary the Report ought to have laid stress on the danger of reverting to the old conception

The trouble is that the authors of the British Plan were confronted by a dilemma They had to display optimism in order to induce a more than half-dubious world to accept their scheme At the same time they also had to try to discourage the financially poor countries from being unduly optimistic when making use of the facilities to be provided under the Plan. Evidently they arrived at the conclusion that the first step was to have the scheme adopted, and preferred to err in the side of optimism, while reserving the right to reverse the gear once the scheme was adopted.

There are several ways in which the British Plan aims at keeping down import surpluses Multilateral trade facilities should in themselves go some way towards that end by enabling weak countries to increase their exports to other weak countries, though in this respect the result will amount to little more than taking in each other's washing. The proposed charge of 1 per cent on debit balances in excess of 25 per cent of the quotas and 2 per cent. if in excess of 50 per cent. is not likely to discourage import surpluses After all, for a financially weak country to be able to borrow abroad at the rate of 1 per cent or even 2 per cent may seem very reasonable indeed. We suggested earlier in this chapter that in the case of credit balances an increase of the percentage to a considerably higher figure might act as an effective deterrent. The same is true, of course, about debit balances. The difference is that while the charge of a negative interest on credit balances tends to solve the problem automatically in reducing the credit balances by the amount of the interest charge, in the case of debit balances it tends to aggravate the problem by increasing those balances. In any case in practice high interest rates would probably be considered inacceptable by creditor and debtor alike.

By far the most effective way in which the Keynes Plan is likely to achieve the aim of keeping down import surpluses is by its stipulations concerning the intervention of the Governing Board in case of large and persistent debit balances The Governing Board has in fact very extensive powers if the debit balance of a country increases above half of its quota It is in a position to require the debtor country to devalue its currency It is to be hoped that this altogether too drastic provision will be modified, for many countries might consider the idea that an international body should be able to order the devaluation of the national currency intolerable. It is bad enough if an international body is in a position to veto a devaluation favoured by a Government. It is much worse if a devaluation can be forced upon a country which is in a desperate need of drawing on its bancor facilities in excess of 50 per cent. of its quota. In practice, this provision would presumably limit the use of bancor facilities to 50 per cent. of the quotas, for few Governments would like to expose themselves to being ordered to devalue their national currency. It should be sufficient if the principle is adopted that in case of adverse balances due to the overvaluation of the currency no obstacles would be raised to devaluation should that solution be decided upon by the Government concerned.

The Report also stipulates that the Governing Board could order the establishment of control on capital exports if not already in force. It is to be hoped that even in the absence of any specific stipulations to that effect financially weak countries will retain a very drastic form of control on capital exports. Otherwise even in the absence of a large import surplus they are liable to run up a big debit balance owing to the outflow of capital. It is the declared object of the Keynes Plan to substitute an expansionist in place of a contractionist pressure on world trade. This can only be done, however, if the contractionist effect of capital efflux is prevented. The extent to which the flight of capital from a financially weak country is apt to lead to contraction of purchasing power is not adequately realised. Yet it stands to reason that if a country loses its gold and foreign exchange reserves in an outflow of capital it has to contract its purchases abroad, while the country which receives those very same reserves cannot extend its purchases for the simple reason that the refugee money is liable to be withdrawn at any moment and cannot therefore be spent.

Finally, the Keynes Plan suggests that the Governing Board should have power to require the surrender of gold or other liquid reserves in reduction of the debit balance of deficit countries. This could be done, of course, also in the complete absence of any currency plan.

One of the outstanding shortcomings of the Keynes Plan is that it does not dare to suggest any really effective way of stopping the increase of debit balances by means of restrictions on imports by the deficiency countries or restrictions on exports by the surplus countries. Yet how else can the authors of the Plan imagine that excessive debit balances would be avoidable during the early post-war years? The world will be simply starved of goods by then, and in the absence of any such restrictions, the chances are that those countries which can afford it the least will over-import. It is true the declared object of the Plan is expansion of world trade, and any suggestion of trade restrictions might be denounced as inconsistency. Even so, such restrictions will be found in practice to be unavoidable. If no allowance is made for them in the Keynes Plan, then in all probability when they have to be applied eventually their adoption would be regarded as an indication that the Keynes Plan has failed in its object. To avoid discrediting the Keynes Plan it would be wise, therefore, to base it on the assumption that during the early post-war years at any rate restrictions on imports and exports will be necessary. In the absence of such restrictions the facilities under the Keynes Plan would soon become exhausted and the Plan would virtually cease to function.

Even after the end of the reconstruction period it would greatly facilitate the working of the Keynes Plan if its influence towards balancing international trade were supplemented by permanent measures of planning It is equally important that exchanges should be fixed in such a way as to give participating countries a chance to balance their foreign trade. If the United States insisted on an undervalued dollar then there would be no hope of achieving a balanced foreign trade position. Inevitably the rich would become richer and the poor would become poorer. The United States could not help accumulating a large bancor balance in spite of any half-hearted efforts on the part of the Clearing Union to discourage it. It is essential to fix the initial parities so as to give the deficit countries a chance, and to adjust the parities as and when this should become necessary in order to restore a balanced trade position. A liberal and unselfish attitude towards requests to the Governing Board to authorise devaluations would do infinitely more towards balancing world trade than any other remedies suggested under the Keynes Plan.

CHAPTER X

BANCOR CREDIT FACILITIES

AFTER the war the world will be in bad need of international credit facilities. In the first place, food supplies will be urgently needed in the liberated countries in order to save the population from the worst effects of the prolonged starvation inflicted on them by the greed of their conquerors. These requirements will be so desperately urgent that it would be unpardonable if any time was lost through discussing the financial aspects of the relief schemes. Relief shipments must be proceeded with immediately to the limit of the supplies and transport facilities available. In all probability they will be financed under Lend-Lease or some similar arrangement, and will be, therefore, entirely outside the scope of any international currency scheme.

Hardly less urgent than relief shipments of food will be imports of materials and equipment needed for the reconstruction of the destroyed means of production in liberated countries. As far as possible these shipments, too, should be arranged under Lend-Lease, but if this should prove impossible they should be financed with the aid of long-term loans In no circumstances must the Keynes Plan be burdened with the task of financing such transfers of capital goods It would be contrary to the fundamental idea of the Keynes Plan. None of these capital goods can be repaid in a short time, and it would be decidedly unsound to finance their shipments with the aid of the short-term credit facilities provided by the Keynes Plan.

It will also be necessary to replenish the depleted stocks of consumers' goods in most belligerent countries. The need for it is not so urgent as for food shipments and the reconstruction of the means of production. These imports, too, must be treated as capital items, as even though they consist of consumers' goods they are not meant for current consumption but for the reconstruction of reserves, whether held by the trade or by consumers. These imports will have to be in addition to current requirements, and it is essential, therefore, that they should be financed outside the Keynes Plan.

The scope of the Keynes Plan should be confined to financing current trade deficits, mainly of a seasonal character. In this respect the Keynes Plan is open to criticism, since it suggests that the facilities under the Plan are meant to cover the abnormal deficits which are bound to arise after the war, after the initial shortages of supply have been overcome. The Report suggests that the bancor facilities will serve the purpose of covering the deficits of weak countries while they adjust their economies to peace requirements. If that should be the case the chances are that those facilities would soon become exhausted and the Plan would not then have a fair chance of proving its worth. The only circumstances in which the Keynes Plan would have a fair test would be if it were allowed to operate under perfectly normal conditions It may be objected that if conditions were always perfectly normal there would be no need for any Keynes Plan or any other currency plan. This view cannot be accepted, however. The Keynes Plan is not meant to be an emergency measure, but an integral part of the world's reformed economic system. Those who suggest that it should serve as an additional relief loan to enable the weak countries after the war to put their house in order overlook the essential fundamental character of the changes to be brought about by the Plan. There would have been every justification for the adoption of the Keynes Plan even if there had been no war. Mankind would stand to benefit by it greatly Admittedly, had it not been for the conditions created by the war it would never have occurred to the ultra-conservative Treasuries to depart from the orthodox system. This does not mean, however, that the Keynes Plan should be treated as an emergency measure, least of all by its authors

The Keynes Plan tentatively mentions alternative financial facilities to those proposed in the Plan. Such facilities are a redistribution of gold held by the United States or direct credits granted by the United States and other countries for the purpose of the requirements envisaged to be covered under the Keynes Plan The redistribution of gold would, of course, be highly salutary and would go a long way towards facilitating the task of the financially weak countries after the war to maintain a stable currency. It would also create a sufficient degree of confidence to encourage those countries to depart from bilateralism and engage in multilateral trade. Nevertheless, the solution compares unfavourably with the one suggested by the Keynes Plan. There is no reason to suppose that the gold, once redistributed, would stay redistributed, in fact, there would be a strong tendency towards its reflux to the United States. The difference between the Keynes Plan and a redistribution of American gold from this point of view is that the latter solution would not provide any apparatus for the prevention or discouragement of unduly quick spending of the new facilities obtained. Once the gold is redistributed neither the United States authorities nor any international authority to be set up for the purpose would have the power to prevent the recipients from doing with it what they like. On the other hand, the utilisation of the bancor facilities in excess of 50 per cent. of the quotas would be subject to various restrictions Moreover, it is in any case useless to advocate a redistribution of gold, since the chances are that the United States would never consent to any such solution.

The suggestion that there should be direct arrangements between the Federal Reserve System and the Central Banks of the countries in need of support may appear more practicable at first sight It would asume the form of an arrangement by which the United States authorities would agree to grant overdraft facilities to foreign monetary authorities, thereby enabling the latter to satisfy current dollar requirements As a day-to-day arrangement this would work satisfactorily. The trouble is that it would be liable to termination at any moment. The moods of Congress are incalculable, and it is easy to imagine that in an Isolationist mood, or even for the sake of embarrassing the Administration, it might at any time refuse to renew its consent for such overdrafts The abrupt cessation of dollar facilities would create conditions similar to those arising in 1919, when the United States authorities suddenly discontinued their support of the European currencies A similar situation cannot arise under the Keynes Plan, since technically it does not involve any American financial contribution towards the scheme. The credit facilities would be provided not by the United States, but by the Clearing Union.

In all fairness it must be admitted that it would be too much to expect the United States to provide everything Europe and other impoverished belligerent countries need. She will be expected to supply a large part of the relief shipments under Lend-Lease and to assist in the reconstruction of destroyed means of production with the aid of long-term loans. It is only right that short-term facilities should be provided from other sources. It is true that in practice if the bancor facilities are spent in the United States, then it is the United States who provides the assistance by her willingness to hold bancor balances Nevertheless, this is not the same as granting actual credit facilities or redistributing gold, because the bancor balances will constitute assets which the United States would be in a position to use in any part of the world just as if it were gold.

The granting of bancor facilities by the Clearing Union would not preclude the granting of private credit financial facilities by banks While long-term investments are suggested to be organised through the intermediary of an International Investment Board, there is no reason why bank credits for foreign trade purposes should not be left to private initiative Such credits would go a long way towards levelling out seasonal fluctuations, and would to that extent relieve the strain on the Clearing Union The latter should aim at no monopoly of short-term credit facilities Its object should be merely to satisfy requirements which could not be satisfied by private initiative

It is essential for the success of the Plan that bancor facilities should not be regarded as a windfall enabling borrowers to increase their luxury imports Since it would be easy to obtain such facilities up to a point, there might be much temptation for spending them too light-heartedly Most belligerents are having a lean time during the war and have to do without many luxuries There will be pressure on the Governments after the cessation of hostilities to resume the imports of such luxuries, and rigid refusal to do so in spite of the possession of bancor resources might incur unpopularity and active opposition Nevertheless, the Governments must refrain from courting popularity by the too liberal use of bancor facilities They must be made to realise that it would not do to exhaust their bancor quotas by importing champagne to celebrate the victory. It would be difficult to impose actual restrictions in the use to be made of the bancor credits. For one thing, even if it were stipulated that these credits could only be employed for certain purposes, there would be nothing to prevent countries which are determined to have a good time at the expense of the Clearing Union from using their other resources for the purchase of luxuries. The situation that might thus arise could best be compared with the financing of German rearmament by British and other foreign bankers before the war. As far as it is known, none of those bankers granted credits to Germany for the specific purpose of financing rearmament Nevertheless, the result was the same as if they had done so, since by providing Germany with credit facilities to cover her civilian requirements, they released corresponding facilities which would have had to be used for civilian requirements and which became available for financing rearmament imports.

Some effective device should be adopted under which countries enjoying bancor credit facilities should be discouraged from the reckless importing of luxuries. The Governing Board should be empowered to make representations whenever it is found that a country which has an overdraft with the Clearing Union is indulging in any excesive luxury imports In too flagrant cases evidence of such imports should justify the discontinuation of further bancor facilities.

The bancor credits should be used for meeting seasonal and other temporary adverse balances. They could best serve their purpose by not being used at all

Once the bancor facilities are exhausted they would become a burden and a liability since they would increase the short-term indebtedness of the financially weak countries It is important, therefore, to draw on the bancor resources sparingly, and to make use of any private facilities offered in order to retain the bancor quotas as a reserve.

The Report rightly emphasises that the Keynes Plan would provide no remedy against fundamental disequilibrium that might arise through a variety of causes. Those who borrow bancor must put their house in order so as to avoid the development of such fundamental disequilibrium. The Clearing Union will play the role of advising the borrowers how to do this, and it is hoped that it will have sufficient authority for this advice to be heeded. If this will be the case the Governing Board will be in a position to ensure that the bancor facilities are used wisely.

CHAPTER XI

THE AMERICAN CURRENCY PLAN

SIMULTANEOUSLY with the Keynes Plan another post-war currency plan made its appearance. It was put forward by the United States Treasury and its principal author is Mr. Harry D. White, Economic Adviser to the United States Treasury. In many quarters it is considered unfortunate that the two principal Allied Treasuries should publish rival currency schemes instead of arriving at an agreement before publishing anything at all. The fact that both Treasuries emphasised that their respective plans contained merely tentative proposals which were open to modifications did not in any way alter the fact that they disclosed a disagreement between London and Washington on many important points. From this point of view the procedure adopted by the Inter-Allied Food Conference held at Hot Springs in May, 1943, was much more promising than the one adopted by the Allied Treasuries. At Hot Springs the Allied delegates arrived at an agreement on a number of general principles. The resolutions thus passed unanimously were too vague to commit any of the signatories to anything vital. Nevertheless, the time and effort applied to the negotiation of this vague agreement was by no means wasted, for the universal acceptance of certain principles created a favourable atmosphere and facilitated the task of reaching subsequent agreement on practical details. On the other hand, the disclosure of disagreement between the United States and Great Britain on the post-war currency plan created an unfavourable atmosphere amidst which it became extremely difficult to make progress towards the elimination of the differences.

In many quarters it was considered advisable that we should bury our heads in the sand and pretend that the discrepancies between the two plans are insignificant compared with the similarities that exist between them No useful purpose can be served by such an attitude While allowing for the similarities it is essential to face the discrepancies squarely. We propose to examine both similarities and discrepancies in subsequent chapters, while in the present chapter we confine ourselves to a brief analysis of the American Plan.

Beyond doubt the American Currency Plan is drafted in an incomparably more business-like manner than the Keynes Plan. Therein lies both its strength and its weakness It contains much less argument and confines itself to stating the plain rules of the proposed system At the same time, however, it is on the whole unimaginative. It might have been drafted by a committee of foreign exchange brokers who know their own Plan, nevertheless it has the same failing as the latter in that in Moreover, although it is more business-like than the Keynes business thoroughly well but have no broad vision. In many respects its provisions are obscure and contradictory. If the American Plan were to be adopted as the statutes of the proposed international institution, it would be a source of endless conflicts regarding the interpretation of various ambiguous points

The American Plan is evidently inspired by the idealistic liberalism of Mr Cordell Hull While the Keynes Plan lays stress on expansionism, the main emphasis of the American Plan is the elimination of restrictions on trade and exchanges. At the same time the Plan is also inspired by Mr. Morgenthau's desire for rigid exchange stability. The following are the main objects of the scheme.—

1. To prevent the depreciation of exchanges in terms of the dollar.
2 To eliminate bilateral trade arrangements.
3 To eliminate or at any rate reduce exchange control.
4. To stimulate international trade.
5. To help in the balancing of foreign trade.

In order to achieve these objects the following provisions have been included in the Plan:—

1 An international institute called the United and Associated Nations Stabilisation Fund is to be created Each member-

country will appoint a representative on its Board of Directors. A limited number of directors will be elected members of the Executive Committee, headed by the Managing Director.

2. Each country will have a hundred votes plus one vote per each million dollars of its participation in the fund's capital. The maximum of voting power for any one country it to be 25 per cent. No important decisions can be taken unless there is a four-fifths majority

3. The capital fund will be $5,000,000,000, of which $2,500,000,000 will be paid up before the fund begins to function It will consist of gold to the extent of 25 per cent. of the paid-up quota (in the case of financially poor countries less), currencies of the member countries to the extent of 25 per cent and securities of the member countries to the extent of 50 per cent.

4. The contributions of the member countries will be fixed according to a formula based on their holdings of gold and foreign exchange, the fluctuations in their balance of international payments and the size of their national incomes. Each country is to make an initial payment of 50 per cent. of its quota The Board of Directors may decide to call up further payments as and when required

5. The Fund will be empowered to engage in most kinds of banking transactions, to buy, sell and hold gold, currencies, bills, Government securities, to accept deposits, to issue its own obligations and to act as an international clearing house, to borrow currencies of member countries, to lend member countries its holdings of their respective currencies, etc

6. The Fund shall have the power to fix the exchange rates of the member countries and to prevent them from altering those parities. It may fix a range within which the currencies are permitted to fluctuate.

7. The Fund will have powers to sell to member countries the currencies of any other member country for the purpose of meeting a trade deficit incurred by the latter in relation to the former.

8. The Fund can acquire currencies of member countries up to a limit that will increase eventually to 200 per cent. of the quotas. It can only purchase in excess of that percentage if the country concerned agrees to carry out measures deemed

necessary by the Board of Directors, or if the Board of Directors is satisfied that the surplus can be liquidated out of a favourable trade balance that is expected to arise in the not too distant future. A charge of 1 per cent. is made on purchases exceeding the maximum percentage, and the country concerned is to provide securities for the surplus.

9. If the Fund's holding of a currency falls below 15 per cent. of the quota of the country concerned, the Board of Directors may submit to that country recommendations of measures to be taken in order to reduce its export surplus.

10. If the supply of a currency becomes short, the Board of Directors shall make every effort to increase it, and shall apportion its sales of such scarce currency according to the urgency of needs from the point of view of the general international situation and of the requirements of the particular countries applying for the scarce currency.

11. Each member country agrees that it will offer to sell to the Fund all foreign exchange and gold it requires in excess of the amount possessed at the time of joining the Fund. The Fund may accept or reject the offer. It also may decide on the limit beyond which the accumulation of privately-held foreign balances is unwarranted.

12. Extensive provisions are made for the liquidation of abnormal balances accumulated during the war

13. The Fund may buy currencies of non-member countries for a limited period.

14. The Fund can only deal directly with Treasuries, Central Banks and other official financial institutions.

15. The monetary unit of the Fund shall be called "Unitas," equal to ten United States dollars of the present weight and fineness. The accounts of the Fund shall be kept in terms of unitas, but no unitas notes will be issued

16. The fund is entitled to accept deposits in terms of unitas from member Governments on delivery of gold. The Fund shall maintain 100 per cent gold reserve against such deposits which are convertible into gold on demand by their holders

17. The Fund has to be indemnified for any depreciation of its holdings of national currencies. A country which devalues

its currency is to make up for the depreciation of the Fund's holding by delivering the necessary amount of its currency.

18. Member countries will undertake to abandon as soon as possible all the restrictions over foreign exchange transactions with other member countries, apart from restrictions on capital transfers, and not to impose any additional restrictions without the approval of the Fund The Fund may make representations to member countries that conditions are favourable for the abandonment of restrictions Effective collaboration will be aimed at to assist in the enforcement of restrictions so long as they exist.

19. Member countries undertake not to enter into any new bilateral exchange clear agreements, nor to engage in multiple currency practices.

20. The participation in the system is subject to termination upon giving two years' notice.

How far are the above provisions suitable to achieve the objects of the American Plan? They are certainly effective in preventing any currency depreciation It is true some vague provisions indicate the possibility of a consent to devaluation, but there are no precise rules under which a country wishing to devalue could claim the Board's consent as its right

The provisions should go a long way towards eliminating a trend towards bilateralism in international trade. Apart from the undertaking not to enter into any new bilateral agreements, the facilities provided by the Fund should be helpful towards enabling member countries to dispense with such agreements. If a country is in a position to pay for its import surplus with the aid of its own currency, then there is no need for it to insist that the exporting country should accept payment in the form of goods. It is not clear, however, from the American Plan to what extent it will be possible for member countries to settle their import surplus with the aid of their own currency. From this point of view the American Plan is highly ambiguous and is liable to give rise to misinterpretation. On the face of it, it would appear that since the Fund has the power to sell to any member country currency of any other member country for the purpose of settling a trade deficit, there should be no limit to the extent to which trade deficits can be settled by such means. While the Fund's holdings of the currency of a member country are subject to limitation, the idea is for the Fund not to hold the currency of the deficiency country but to resell it immediately to the surplus country and thus to obtain the currency of the latter for the purpose of enabling the former to pay for its import surplus. Nevertheless, the Plan considers it necessary to foreshadow the possibility of a scarcity of the currencies of surplus countries. There is apparent contradiction between this anticipation and the earlier provision under which the Fund appears to have the right to acquire currencies of surplus countries to the extent of their surplus. The explanation is that the loosely-worded provision about the Fund's powers to sell any member currency to any member country means the right to sell currencies out of its own holdings, at the buyer's request. The Fund has no powers to compel any country to buy an unwanted currency, even though the wording of the Plan conveys that impression.

Under the letter of the American Plan the Fund has no actual power to compel the removal of exchange restrictions. In practice, however, the weaker member countries could ill afford to disregard representations made to that effect by the Board of Directors. For this reason the American Plan should be able to reduce the extent of exchange restrictions, at any rate during the period while the financially weak countries can obtain facilities from the Fund. In the long run, however, the American Plan's efforts to remove exchange restrictions are certain to defeat their own object since the outflow of capital that is likely to take place sooner or later would exhaust the facilities offered by the Fund, and the financially weak countries would then be forced to revert to restrictions.

The American Plan seeks to achieve the aim of balancing foreign trade, partly by discouraging deficit countries from the excessive use of the facilities provided under the Plan, partly by inducing them to change their economic policies in order to reduce their deficit, and partly by seeking to induce surplus countries to change their policies in order to reduce their surplus.

Beyond doubt the American Plan lacks a profound philosophical background. It does not create additional purchasing power but merely redistributes existing purchasing power. Since the facilities to be created under the White Plan are relatively moderate in size, the extent to which the Plan is capable of contributing towards solving the problems it sets out to solve is necessarily limited.

Finally, the creation of an international monetary unit, the unitas, does not form an integral part of the scheme. It could easily be dispensed with, without affecting the merits of the scheme to any noteworthy extent There is nothing in the text to indicate that facilities would be granted in terms of unitas, or that the participants would be using that unit for settling their balances

The foregoing description of the American Plan is admittedly rather sketchy. During the course of the next three chapters, however, its principles and details will be examined by means of a comparison with the British Plan.

CHAPTER XII

SIMILARITIES BETWEEN THE TWO CURRENCY PLANS

ECONOMISTS have every reason to look upon mathematicians with envy for dealing with an exact science. In mathematics there can be only one right solution, and any other result must obviously be wrong. In the sphere of the "dismal science," on the other hand, there can be several right solutions and many more wrong solutions, and in between them innumerable degrees and shades of rightness and wrongness; hence the proverbial habit of economists always to disagree.

A British and an American financial expert set out independently of each other to solve the same problem, that of the world's post-war currency system. It would have been a miracle, or at any rate a most amazing coincidence, if they had arrived at exactly the same solution For one thing, their mental make-up is totally different On the one hand, we have Lord Keynes, one of the most brilliant figures of our age, with a wide range of interests among subjects well outside the borders of economics, and with a highly imaginative and unconventional mind. On the other hand, we have Mr. Harry D. White, a prominent technical specialist in monetary problems, whose interests are largely confined within the sphere of his special subject, and whose association with the United States Treasury for the last ten years has developed his practical sense at the expense of the philosophical background he possessed before as an academic economist.

Apart, however, from the personal element, there are many fundamental reasons why the British Plan was bound to differ from the American Plan First of all, the war has deprived this country of the bulk of its international assets, while it has further increased those of the United States This means that any British Plan must necessarily be based on the poor man's point of view, while any American Plan is liable to be compiled from the rich man's point of view. It also stands to reason that any British Plan is necessarily if subconsciously influenced by a desire to restore the pre-war *status quo* regarding the balance of power in international trade and finance, while any American Plan wishes to retain the advantages gained by the United States during the war in this sphere It is also natural that the United States should aim at achieving a fairly rigid monetary stability, since, being in possession of a huge gold reserve, it is easy for her to maintain the stability of her currency, while Great Britain should wish to reserve the right of elasticity, owing to the fact that in her case the maintenance of rigid stability might entail very substantial sacrifices. There is also the difference between the point of view of the world's largest producer of gold, the British Empire, and the world's largest holder of gold, the United States It is also understandable that the United States, with her immense liquid resources and with the prospects of a favourable trade balance, should favour the removal of exchange restrictions, while Great Britain should wish to safeguard her exchange by means of control. Over and above all, there is the difference between the outlook of a country which can afford to continue the wasteful system of competitive individualism and a country whose only chance to escape poverty is by achieving full employment and the best utilisation of its resources, with the aid of a scientific planning of her economy behind the protective walls of a controlled exchange.

If we allow for all these considerations, then we must confess that what is surprising is not that there are so many points of difference between the British and American Plans, but that there are so many points of similarity. If two countries view the subject from such diametrically opposite points of view as those of Great Britain and the United States, then the existence of many points of agreement between them must be regarded as gratifying

Throughout the controversy that followed the publication of the two Plans, many politicians, especially official spokesmen, and writers, especially "yes men," went out of their way to emphasise the degree of similarity between the Plans Even they have failed to realise, however, the extent to which the two

Plans actually agree. Nobody has so far taken the trouble of compiling a really comprehensive list of these points, even though it would have strengthened considerably the argument that the gap between the two Plans is not unbridgable. The object in drawing attention to the points of similarity ignored by these people is not to minimise the difficulties in coming to agreement, but simply to register the plain fact that a high degree of agreement already exists. The best way of achieving this end is to draft an imaginary joint British-American Declaration which could have been compiled by Lord Keynes and Mr. Harry White if, instead of working out their respective Plans independently, they had come together with the object of ascertaining and registering the degree of agreement that existed between them. The following list of points is based entirely on the text of the two Reports, and does not in any sense allow for any compromise that could easily be reached on a number of additional points in repect of which the differences are not insurmountable:—

1 The objects of the post-war currency system must be to achieve a reasonable degree of stability of exchanges, to stimulate international trade on a multilateral basis, to facilitate the balancing of trade in the long run, and to enable weak countries to meet their trade deficits during the transition period

2 Both parties agree that these objects can be furthered through the adoption of an international currency scheme instead of allowing developments to take care of themselves as after the last war

3. Relief shipments to cover urgent food requirements and those of the restoration of the means of production in liberated countries, and also the requirements of long-term capital investments are excluded from the proposed scheme Nevertheless, they have to be solved by means of arrangements outside the scheme in order to create the preliminary conditions in which the scheme could operate

4 Both parties realise the inevitability of a transition period during which even the current trade balances of the weak countries, as distinct from their capital requirements, are likely to show a deficit. They realise the necessity for enabling these countries to import in excess of their exports during that period.

5. Both parties agree on the need to avoid disorderly exchange fluctuations and competitive exchange depreciations. They consider it necessary to maintain a reasonable degree of stability and provide for orderly modifications of exchanges whenever these appear to be inevitable.

6. The tendency towards bilateralism in trade and exchanges must be discouraged, and the system of blocked balances must be brought to an end An exception is to be made, however, regarding abnormal balances accumulated during the war, which will have to be liquidated gradually.

7. It is the object of both parties to facilitate multilateral trade by enabling financially weak countries to import without having to stipulate that the only way exporters can obtain payment is by the purchase of their goods.

8. Both parties realise the necessity of a better redistribution of the international means of payments after the war, in order to enable countries whose gold reserves have become depleted through the war to import on a reasonable scale, pending the restoration of their full capacity of export

9. In order to achieve all these objects it is necessary for all countries to submit voluntarily to a certain degree of international discipline and to sacrifice part of their sovereignty.

10 On the other hand, there must be no excessive interference with the internal economic policies of the participating countries, and certainly no attempt at forcing them to adopt a uniform policy The participating countries should have the right to withdraw from the arrangement on giving reasonable notice

11. Both parties assume the possibility of restoring the equilibrium of the international balance of payments of the participating countries in the long run Otherwise the present scheme would only act as a palliative and would fail to provide a lasting solution in face of fundamental and perpetual disequilibrium.

12 Both parties agree on the need for restricting unplanned capital movements, speculative foreign exchange operations, and the unauthorised accumulation of privately-held foreign assets.

13 The countries participating in the scheme must undertake to refrain from operating in each other's markets, currencies or securities without the consent of the countries affected

14 Gold must be retained as the international standard of value and as the medium suitable for keeping international reserves and for settling international balances. Its role in the particular currency systems should be left for the individual countries to determine.

15. For the purposes of the scheme, the establishment of an international institution controlled by the Treasuries of the participating countries is proposed. It shall have no dealings with private interests, only with Treasuries, Central Banks and other official institutions. It will have a Board on which participating countries will be represented, and an executive appointed by the Board. Voting rights of the participating countries will be determined according to their relative economic importance, subject to the necessity of preventing any particular country from achieving a dominating position.

16. The international institution will create an international monetary unit, not for the purpose of issuing it for circulation or for general use, but solely for the purpose of its accountancy and for fixing the exchange rates of the currencies of the participating countries in terms of the unit. Deposits may be accepted in terms of the international unit from the participating Governments and Central Banks.

17. The credit facilities to be provided by the international institution for financially weak participating countries are to be allocated on the basis of quotas determined by their relative legitimate requirements

18. The use of the credit facilities must be subject to conditions in order to prevent their abuse In given circumstances, the Board of the international institution may insist on certain measures to be carried out by the debtor country as a condition for obtaining further facilities

19. The accumulation of credit balances arising from excessive export surpluses must be discouraged by the institution. The Board may submit to surplus countries recommendations concerning measures which would tend to reduce their surplus

20. The institution will be authorised to have limited dealings with non-member countries.

21 The institution will be authorised to levy moderate charges on its transactions.

22. Any country defaulting on is obligations to the institution or disregarding the demands which the Board is entitled to make will be declared to be in default, and will cease to enjoy the benefits of facilities, while still remaining responsible for its liabilities under the scheme

23 Participating countries will furnish the institution with all the information it needs to enable it to judge the position of the countries concerned In particular, the institution will collect information concerning officially and privately held foreign assets of the participating countries.

24 All the above points are tentative proposals open to modification to bring them in accordance with the views and requirements of other countries which are to join the scheme

The above list contains only the points on which there is actually agreement between the texts of the two Plans. It would be possible to compile a further large number of points on which the discrepancy between the two Plans is so slight that agreement could have easily been reached if it had been attempted before the publication of the Plans In respect of these points, the discrepancy is simply due to the fact that the two Reports have been elaborated independently of each other. It would thus be possible to produce a very impressive joint British-American Plan without any difficulty by registering the points on which agreement has been reached or can easily be reached.

Nevertheless, it would be a mistake to underestimate the difficulty of reaching agreement on a Plan which would be practicable and helpful. As we shall see in the following chapter, there are many important points on which there is fundamental disagreement between the two plans, and it is inconceivable that a joint Plan could be agreed upon unless and until a compromise is reached on these points Without such compromise the agreement on various principles and details indicated above, while impressive in theory, would be of little practical value.

CHAPTER XIII

DIFFERENCES BETWEEN THE TWO CURRENCY PLANS

In dealing with the differences between the two currency Plans it is necessary to discriminate between differences arising through the independent drafting of the two plans, differences of minor detail, those of major provisions, and finally the differences between the fundamental philosophy of the plans. We need not concern ourselves with the differences due solely to the fact that the Plans were elaborated separately. It is inconceivable that had Lord Keynes and Mr. White been sitting at opposite sides of the same table they could not have come to agreement upon matters such as the percentage to be charged on the operations carried out by the international institution or the percentage beyond which overdraft facilities would be made subject to the execution of certain measures demanded by the international Board. Nor need we concern ourselves with all the differences of minor detail which could obviously be straightened out without much difficulty. It is onlv those differences, whether of detail or of principle, which arise from the dis-similarity of the fundamental character of the Plans, or from the difference between the objects their authors have in mind, that have to be investigated. The following is a brief summary of these differences:—

1. The British Plan proposes to call the international institution an International Clearing Union, while the American Plan wants to name it a United and Associated Nations Stabilisation Fund. This disagreement would be of no consequence if it were not for the fact that it indicates a difference between the main object of the plans envisaged by their authors. Evidently the accent in the British Plan is on the functions of the international institution as a Clearing House, while the name of the institution in the American proposal emphasises its functions as a stabiliser of exchange rates.

2. The name of the proposed monetary unit under the British Plan is the Bancor, and under the American Plan it is Unitas. In this instance the difference does not follow from any fundamental difference in the two Plans. On the contrary, if the two Plans had swapped names, their choice would appear to be more logical Since gold plays a more important part in the American Plan and the American monetary unit is convertible into gold, it could be more appropriately be called Bancor—a horrid, vulgar name more suitable for some boot-polish or patent medicine than for an international currency. On the other hand, Unitas indicates a quality which the currency in the British proposal possesses to a much higher degree than the one in the American proposal

3 The British Plan does not indicate the proposed gold value of the Bancor. On the other hand, the American Plan wants the Unitas to be equal to ten dollars. This would mean that for all practical purposes the international currency unit would be the dollar. The desire of the United States to put the new system on a dollar basis throws some light on the attitude of the Washington Treasury towards the balance of power in international finance and trade.

4. Under the British Plan the proposed international currency would be inconvertible into gold, though the Clearing Union would have the option of taking the initiative for converting part of the Bancor balances if it has an adequate gold supply available Under the American Plan, Unitas would be freely convertible into gold on demand by its holders. It follows from this difference that the Bancor need not have any security since its holders have no right to demand its conversion, while the Unitas has to be covered by a 100 per cent. gold reserve

5. The Clearing Union would be under statutary obligation to buy gold from Treasuries and Central Banks at a fixed price. While it would have the authority to alter its buying price, no frequent alterations appeared to be envisaged, and while a certain price is in force any Government or Central Bank has the right to deliver to the Clearing Union any quantity of gold and demand payment in Bancor On the other hand, the Stabilisation Fund would be under no obligation to buy gold at a fixed price, whether against Unitas or against foreign exchange. In

this respect the statement made by Sir Kingsley Wood on the occasion of the Debate on the Keynes Plan in May, 1943, in the House of Commons that the Unitas is convertible both ways is erroneous. Article 8 of Chapter III of the American Plan clearly states that the Fund may accept or reject the offer of gold. Again, Article 3 of Chapter IV states that deposits in terms of Unitas *may* be accepted by the Fund upon the delivery of gold, but clearly implies that there is no absolute obligation to do so. It is difficult to explain this difference, which may conceivably be due to deficient drafting, and need not necessarily indicate the true intentions of the authors of the scheme. On the other hand, it is possible that while the British Plan aims at creating an outlet for the gold output of the British Empire, the American Plan wishes to reserve the right to refuse to purchase newly mined gold

6. The Bancor is a vital part of the British Plan. Facilities are granted in terms of Bancor, and all international settlements through the Clearing Union are effected through Bancor accounts The Unitas, on the other hand, is quite an unessential part of the American Plan. Facilities are granted in the form of selling to debtor countries the currencies of their creditors, and transfers are effected in national currencies only The sole object of Unitas is to serve as the monetary unit for special deposits.

7 Under the British Plan the participating countries need not make any initial contributions towards the resources of the proposed institution. On the contrary, they are entitled to begin by overdrawing their accounts before having any balance on them Under the American Plan the participating countries would have to deposit 50 per cent. of their quotas, part of which must be contributed in gold and the rest in their national currencies and Government bonds.

8 Under the British Plan the Clearing Union would create credit for the benefit of deficit countries. Under the American Plan the Stabilisation Fund would simply redistribute the funds accumulated from its members

9. Under the British Plan participating countries would be allowed to devalue their currencies to the extent of 5 per cent in given circumstances without the authorisation of the Board. Under the American Plan any change in the values of currencies,

apart from their fluctuations within the authorised limits, would require the Board's permission.

10 Under the British Plan the circumstances in which the Board has to give its consent to a devaluation of the currency are indicated. Under the American Plan they are left vague.

11. Under the British Plan a simple majority is sufficient for a decision to alter the value of currencies. Under the American Plan a four-fifths majority is required, so that a country with a participation of over 20 per cent. would be in a position to veto any unwanted changes.

12. Under the British Plan detailed measures are recommended to countries with excessive debit or credit balances in order to achieve an equilibrium of their trade balance. Under the American Plan no details are given.

13. Under the British Plan the quota of each participant, which is to determine the amount of its overdraft and also its voting power on the Board, is to be fixed according to the average total of its imports and exports during the last three pre-war years. Under the American Plan the quota is to be fixed on the basis of the size of the gold reserve of the participating countries, their national income and the range of fluctuation of their trade balance.

14. Regarding exchange restrictions the attitude of both Plans is rather contradictory. The British Plan would clearly prefer the maintenance of exchange control not only over capital transfers and speculative transactions, but also over commercial transactions. Nevertheless, it states that members of the Union should not allow any restrictions on the disposal of receipts arising out of current trade or invisible income The American Plan is decidedly in favour of the removal of all restrictions on current trade transactions, though contradictory regarding restrictions on capital transfers. One of its declared objects is to reduce the use of foreign exchange controls that interfere with world trade and the international flow of productive capital. On the other hand, in Chapter VI its declares itself in favour of maintaining restrictions on capital transfers.

15. Under the British Plan it would be possible to continue existing arrangements such as the sterling area. Under the

American Plan such arrangements are not actually excluded but are obviously not favoured.

16. Under the British Plan it would be possible for countries holding Bancor balances or possessing unused Bancor overdraft facilities to exercise their purchasing power in any one of the participating countries. Under the American Plan there seems to be a limit to the extent to which the purchasing power provided by the Stabilisation Fund can be exercised in any one particular country. The limit is not clearly defined, however.

17. There is a difference of detail between the way the two plans propose to treat the abnormal balances accumulated during the war.

18. The amount of the facilities under the British Plan is much larger than under the American Plan. Sir Kingsley Wood estimated the facilities under the British Plan at $25,000,000,000, but only allowed for the quotas of the United Nations, and since sooner or later all neutral and ex-enemy countries are expected to be admitted the grand total will rise to something like $40,000,000,000. Under the American Plan the authorised capital of the Stabilisation Fund would be $5,000,000,000, but only one-eighth that amount would be paid in gold. Thus facilities under the Keynes Plan would be about between twenty and thirty times as large as under the White Plan. In reality the difference would not be nearly as pronounced All countries could not possibly use their overdraft facilities under the Keynes Plan, for the simple reason that only deficit countries would need it, and since the deficit of country A must necessarily be the surplus of country B, in practice the maximum would only be part of the authorised total Even that part would not be fully used. Any country wanting to use more than 50 per cent. of its quota would have to accept far-reaching intervention in its internal economic policy. For this reason as a general rule countries would try to abstain from exceeding 50 per cent. of their quota. Thus in practice the limit of the overdraft facilities under the British Plan would be somewhere between $10,000,000,000 and $20,000,000,000, but probably nearer the lower figure.

19. Apart altogether from the amount and nature of facilities, the British Plan is more expansionary than the American Plan.

This difference should not, however, be exaggerated The British Plan contains several provisions of a contractionist or at any rate anti-expansionist character. It provides for a reduction of quotas but not for their increase beyond their restoration to their original level On the other hand, it is true, provisions are made enabling the Board to advise surplus countries to adopt expansionary measures.

20 The British Plan is more adaptable to changing conditions and its authors are more prepared to revise it in the light of initial experience. Decisions can be taken by a simple majority, while in the American Plan any major decision requires a four-fifths majority In the British Plan there is special provision for changes, the necessity of which might become realised within the first five years of its existence No such provision exists in the American Plan, the alteration of which might well become as difficult as an alteration of the American Constitution.

21 The American Plan would perpetuate the maldistribution of gold by stipulating that any country acquiring gold or foreign exchange after having joined the scheme would have to offer the surplus for sale to the Stabilisation Fund The British Plan, on the other hand, provides for the redistribution of gold through the intermediary of the Clearing Union.

22. Under the British Plan, overdrafts are granted entirely without security to the extent of 50 per cent of the quotas. It is only if the overdraft exceeds 50 per cent. that the Governing Board may require the member State to deposit gold, foreign or domestic currency or Government bonds according to the capacity of the State concerned Under the American Plan, on the other hand, member States have to deposit 50 per cent. of their quotas in gold, national currencies and Government bonds before even they avail themselves of their overdraft facilities If the net holdings of the Fund of any local currency exceed the quota of that country, additional security has to be deposited

23. Both Plans provide for the establishment of an international bank, but in the American Plan the banking character of the proposed institution is much more pronounced. The Stabilisation Fund is authorised to transact most kinds of banking business and even to issue its own bonds. There are no such

provisions in the British Plan. Altogether the American Plan reads like a prospectus of a share issue, or the statutes of a company, rather than a monetary reform programme.

24. The general impression created by the British Plan is one or bold reform, aiming at a change of the fundamental conception of money in its international aspects. The American Plan, on the other hand, is incomparably less ambitious. It simply aims at extending existing international banking and currency arrangements.

CHAPTER XIV

IS A COMPROMISE POSSIBLE ?

THE simultaneous publication of the British and American Currency Plans was followed by a burst of heated controversy on both sides of the Atlantic. Each Plan was subject to a great deal of attack in its own respective country, but as compared with the abuse they came in for from the other side, their criticism at home sounded almost like praise. The American press and politicians in particular were outspoken in attacking the Keynes Plan A well-known Isolationist Senator declared that it aimed at nothing less than placing the American gold reserve under British control. A German refugee economist in Chicago declared that the aim of the Keynes Plan was the redistribution of the assets of the United States among foreign countries. Others again presented Lord Keynes as a modern Machiavelli, whose sinister intention was to compel the United States to spend her export surplus abroad. Considering that between the two wars one of the main sources of all our economic troubles was that the United States was unwilling to spend abroad the proceeds of her exports, it would be safe to plead guilty on that count at any rate. The Keynes Plan is also accused of aiming at placing purchasing power in the hands of Europe, enabling her to buy large quantities of American goods. Considering that the United States is very anxious to sell, this can hardly be regarded as a major crime, especially from the point of view of American exporters. Another charge raised against the Keynes Plan is that its sinister intention is to bolster up the standard of living in Great Britain Others, again, attribute to the British Plan the intention of obviating deflation in Great Britain and passing it on to the United States Other people suggest, however, that the aim of the Keynes Plan is exactly the opposite, to force inflation on the United States

Compared with these extreme and often contradictory accusations from the American side, the British press and British politicians displayed a commendable degree of moderation. in dealing with the American plan Critics of the American Plan suggested that Mr. Cordell Hull wished to force his out-of-date Free Trade principles on an unwilling world, and that it was to that end that the American Plan endeavoured to secure control in the economic sphere. Less charitable critics accused the United States of economic Imperialism. Among the points of criticism which received publicity there was a suggestion that the main object of the American Plan was to prevent the devaluation of the pound at all costs and to keep sterling permanently overvalued.

While exaggerated attacks are not helpful, it is wrong to deprecate plain speaking on the subject of post-war currency, or indeed on any subject affecting British-American relations during or after the war. Since British and American interests do clash in many respects, nothing would be gained by pretending to ignore this fact. Indeed, frank discussion of differences, provided that exaggerations are avoided, may do more good than harm

At the same time, it would be idle to deny that the bitter feelings caused by the exaggerated criticisms aroused in both countries by the conflict between the two Plans, whether or not voiced in public, were detrimental to the unity that is necessary in the interests of victory. This gave rise to suggestions that it was altogether a mistake to raise this matter at the present stage, for no advantage that could conceivably be gained by concluding arrangements about the post-war currency system could possibly make up for the grave disadvantage of the weakening of British-American collaboration during the war. It might have been wiser to leave this matter severely alone, or at any rate to discuss it behind closed doors. There would have been no harm in maintaining the existing currency arrangements for twelve months after the war, during which time a new system could have been elaborated.

An attempt at reconciling the two currency Plans was made by the Canadian Government, which published a Plan of its own. Its idea of conciliation was, however, to accept the

American Plan to the extent of at least 90 per cent. and concede 10 per cent or less to the British Plan for face-saving purposes. Its similarity to the American Plan earned it the nick-name of "Off-White" Plan. Most essential points of the American Plan are incorporated in the Canadian Plan, and it follows the British Plan mostly in minor details. For this reason it is hardly worth while to devote much space to the discussion of this attempt.

Most unofficial critics of the Plans on both sides of the Atlantic have adopted an unhelpful attitude There have been so far but few constructive suggestions of a compromise. The following is an attempt to ascertain how far this country could afford to go towards meeting the American point of view and on what points it is essential to hold firm even at the risk of a breakdown of the attempt at compromise The points of difference enumerated in the previous chapter are dealt with one by one.

1. While "Clearing Union" is a decidedly better name than "Stabilisation Fund," neither is really adequate since the institution under both Plans has the characteristics of a bank. For considerations of expediency, both Plans prefer to abstain from calling it a bank There would be no harm in giving way to the American Plan and accepting the name of Stabilisation Fund

2. Bancor is a horrid name, and almost anything would be an improvement on it Although the choice of unitas is not exactly ideal (it recalls a much-advertised disinfectant), it is to be preferred to bancor. Possibly both Treasuries may think again and discover some more palatable name. But if it pleases the United States Government and American opinion that the American name should be accepted, let us accept it by all means

3. Nor is it worth while to put up a hard fight against the American attempt at making the new unit equivalent to ten dollars This may be strongly opposed by British banks for fear that it would mean the recognition of the dollar as the international currency, which would be detrimental to the use of sterling in international trade and finance This argument is, however, grossly exaggerated Under both British and American Plans the monetary unit would only be used by the international institution for purposes of accountancy and in its relations with

Central Banks and Governments. Under the British Plan it would also be used in transactions between the Central Banks. As far as the public is concerned, the international monetary unit would mean nothing. No individual, firm or bank, other than Central Bank, would ever be likely to have any transaction in the new unit, and for this reason it is unimportant whether it represents the gold equivalent of the pound sterling or the dollar, or simply a certain weight of gold unrelated to either of these currencies. Admittedly, under the American Plan the arithmetic of conversion from dollars to unitas and *vice versa* would be very simple. If, however, the sterling-dollar parity is fixed at a round figure (say, four dollars per pound), then conversions between sterling and unitas would be almost as simple. If in return for concessions in other directions the British negotiators conceded this point, it would not harm vital British interests.

4. On the other hand, it is essential to resist the American proposal for the free convertibility of the international currency into gold. If that condition were accepted it would mean that one of the main objects of the Plan, which is to induce creditor countries to collect their claims in goods instead of insisting on payment in gold, would be weakened. One of the great advantages of the Keynes Plan lies exactly in the fact that under it a currency is created which can be used for international payments in the same way as gold, and which would be additional to the gold available for that purpose. This object would be defeated if holders of the international currency were in a position to demand gold from the international institution As a matter of fact, since unitas plays a very subordinate part in the American Plan, it is of relatively small practical importance whether or not it is convertible into gold On the other hand, since bancor plays a vital part in the British Plan, its convertibility into gold would change that plan fundamentally and would change it distinctly for the worse.

5. It is not clear whether the absence of any provision in the American Plan to make it compulsory for the Stabilisation Fund to buy gold at a fixed price is intentional, or whether it is due to deficient drafting. On the face of it, it is directed against the interests of producing countries which would thus be deprived

of a certain outlet for their output at a fixed price. The absence of a provision for the compulsory purchase of gold appears to be, however, also against American interests. In theory, it would be possible for the price of gold to fall below the official price paid by the international institution, which would be clearly against the interests of the largest holder of gold In practice the institution would be able to prevent such a fall by voluntary purchases of gold. Another point of view from which it would be to the interests of the United States to accept the provision of the British Plan concerning the purchase of gold by the institution would be that in the absence of such provision the United States would remain the sole dumping-ground for the unwanted gold of every country.

6. The British negotiators should stand firm in favour of the adoption of an international unit which really plays an effective part in the system Unless it is agreed that facilities should be granted to particular countries in terms of the international unit, and that trade balances should be settled by transfers in terms of that unit, there is no point at all in its adoption. Since under the American Plan the unitas deposits could only be created through the sale of gold to the international institution, since those deposits have to be covered by a 100 per cent. gold reserve, and since they have to be repaid in gold on demand, the whole system merely amounts to another form of earmarking and unearmarking gold. The only difference is that instead of reserving the actual gold bars deposited, the depositor would only be able to claim an equivalent quantity of bar gold.

7 The British Plan is decidedly in favour of countries which cannot afford to make an initial contribution to the capital of the international institution. That contribution under the American Plan is, however, very small, since the greater part of it would have to be supplied in national currency and Government Bonds In the case of the poorest country, the amount of gold to be contributed need not exceed 5 per cent of the quota, which most countries could afford. If not, it would be possible to arrange for a loan of that part of the initial contribution There would be no harm in accepting the American Plan regarding the necessity of an initial contribution; indeed, it might be advisable to create a reserve fund by such means for the pur-

pose of covering bad debts. Technically, there is no need for making provision for that purpose. After all, if a participating country defaults, all that happens is that it would refuse to sell its goods against payment in bancor which would be used towards the settlement of its overdraft. The same amount of bancor balance would then have to be spent in a smaller number of countries. If the number of defaulters is small and the total involved is but a fraction of the total bancor facilities, then there is no cause for concern. If, on the other hand, many countries with large amounts of bancor overdrafts were to default, the situation might become serious, unless the international institution possessed a reserve fund out of which to cover such defaulted debts. It would be, therefore, advisable to accept the American provision for initial contributions on the understanding that these contributions should only constitute a contingency reserve and not the working capital of the institution, as suggested by the American Plan.

8. All the Fund can do is to sell or lend its own resources of creditor currencies to the debtor nations. Its scope and resources are very limited indeed. In the circumstances, the British Plan, with its more extensive facilities is to be preferrer, and it would be most deplorable if its provision for the creation of bancor facilities were to be dropped in favour of the American system, under which comparatively modest resources asquired by the institution would simply be redistributed. The great advantage of the British Plan is exactly that it provides for a considerable expansion of international purchasing power While the American Plan simply creates just another Bank which would re-lend its resources, the British Plan would bring about a fundamental change in the monetary system by making it possible to apply the principles of monetary expansion in the international sphere This would be an immense step in the right direction, and British negotiators should not give way in this respect.

9 It is not surprisng that under the American Plan devaluation is made more difficult than under the British Plan. Even the latter errs on the side of excessive rigidity, especially if we bear in mind that any law-abiding Government can only over-rule the decision of the Board against the devaluation

of its currency by giving twelve months's notice to discontinue its participation in the arrangement. The American Plan provides for fluctuations within authorised limits, but does not specify whether it has in mind the narrow range that existed between the gold points under the gold standard, or a much wider range. It is inconceivable that the American Plan should want to provide for wide fluctuations, however. From the point of view of vital British interests it would be fatal to link sterling to gold and the dollar too rigidly. For this reason the British formula should be drastically revised in order to ensure the degree of elasticity that is indispensable in order to enable Great Britain to pursue an expansionary internal monetary policy. Indeed, there is a strong case against accepting the ruling of any international Board on such a vital matter as the value of the national currency.

10. The British Plan somewhat mitigates the disadvantage of submitting decisions about devaluation to the Board by laying down certain rules about the circumstances in which the Board is expected to give its consent. The definition of these rules should be much more precise in order to be acceptable. The reference to the subject in the American Plan is even more vague than in the British Plan

11. The claim to secure for the United States the right to veto any change in the value of other currencies should in no circumstances be accepted.

12. Both Plans are in favour of authorising the Board to require debtor countries to take certain measures, and to request creditor countries to take certain measures in order that their trade should be balanced. While the British Plan goes into detail of the measures suggested, the American Plan remains vague There is everything to be said in favour of being even more precise than the British Plan in this respect.

13 Both British and American Plans suggest a formula which would secure the largest quota for their respective countries. In this respect, however, the American Plan goes incomparably further than the British Plan. The latter could have found a formula even more favourable to British interests than the one chosen, if, instead of suggesting that the quotas should be based on the total imports and exports, it had

suggested that they should be based on imports alone. This would have had the merit of being logical, considering that the facilities to be provided by the international institution are for financing imports and not exports. Moreover, since before the war Great Britain had a huge deficit on her visible trade, her relative share of the world's total imports was much higher than her relative share of the world's total foreign trade. The extent to which Great Britain tried to benefit by the choice of formula was insignificant compared with the American attempt to the same end. If the quotas were determined according to the size of the gold reserve and national income, then the United States would naturally have the maximum quota of 25 per cent., while according to American calculations the whole of the British Empire would only have 17½ per cent, and the participation of Soviet Russia would be under 5 per cent. This formula would be obviously unacceptable to many participants.

The two Treasuries might reasonably have been expected to come to terms at least on this matter before communicating their Plans to the Allies. In the course of the debate on the Keynes Plan in the House of Commons, Sir Kingsley Wood declared that he was quite prepared to accept the American point of view regarding quotas. This was a major concession given away in advance before even the negotiations started. While in given circumstances it might be generally advisable to satisfy American prestige by agreeing to a larger quota for the United States than for any other participant, such a major concession should not have been given away unless and until it was evident that the American negotiators in turn were also in a conciliatory frame of mind. Of that there has been little evidence so far.

14. If there is one point in respect of which the British point of view must in no circumstances give way, it is in respect of the attitude of the two Plans towards exchange restrictions. Under the British Plan, it would be purely optional for the participating countries to maintain or remove their exchange restrictions. Under the American Plan, too, it would, in theory, be left to the discretion of the participating Governments whether to maintain or remove restrictions on foreign exchange transactions connected with foreign trade The Stabilisation Fund

would reserve, however, the right to bring strong pressure to bear on the participating Governments in favour of the removal of exchange restrictions. What is perhaps even more important, under the American Plan any country which maintains exchange restrictions would appear to be in an inferior position compared with the countries with a free foreign exchange market. The result would be that, in addition to pressure on the part of the Board of the Stabilisation Fund, the Governments of countries with exchange restrictions would be under constant pressure on the part of a large section of public opinion, which would consider it a matter of prestige that exchange restrictions should be removed. In Great Britain, in particular, pressure on the part of the City would become irresistible. The Government would be urged by bankers and merchants to remove exchange restrictions so that " the pound should look the dollar in the face." This phrase may ring familiar to those who remember the monetary controversies that followed the last war, when for considerations of prestige the pound was restored to its pre-1914 parity. The ruinous consequences of this policy of prestige are only too well known, and most people agree now that in possession of our superior knowledge based on experience we shall not commit the same mistake after this war. On the other hand, many of those who are determined not to repeat the same mistake are fully prepared to commit another mistake just as grave as the return of the gold standard at pre-war parity was in 1925 The consequences of a removal of exchange restrictions would be in no way less disastrous than those of the deliberate over-valuation of the pound after the last war.

Under the British Plan the maintenance of exchange restrictions would be made to appear perfectly " respectable " and there would be less inducement for their premature removal—or, indeed, for their removal at any time—for considerations of prestige. Nor would the international institution make use of its immense power to persuade reluctant Governments to remove exchange restrictions against their better judgment. There can be no compromise on this point The British Plan, by agreeing that participating Governments are at liberty to restore a free foreign exchange market, should they wish to do so, has gone as far as it can reasonably be expected to go in this direction.

If there could be no British-American Agreement, and consequently no International Currency Plan, unless the American formula regarding exchange restrictions were accepted, then it would be infinitely preferable to abandon the idea altogether rather than to expose this country to the disastrous consequences that would inevitably follow a return to free foreign exchange dealings in the changed circumstances

The question of exchange restrictions is of such immense importance that I propose to deal with it in detail in a separate chapter.

15. The British negotiators should insist on reserving their right to maintain the sterling area notwithstanding the proposed international system; indeed, Great Britain stands to gain much more through the extension of the sterling area than through participating in any international scheme. In spite of this the international solution should be adopted if possible for the sake of helping weaker countries There is, however, a limit to the sacrifices which this country can be expected to make, and to give up the Sterling Bloc would go decidedly beyond that limit. There is no reason whatever why the continued existence of the Sterling Bloc should be regarded as incompatible with the proposed international scheme, whether it follows the British or the American Plan.

16. The British negotiators should agree that a limit should be placed on the extent to which holders of bancor exercise their purchasing power in any single country. The limitation of such use of the bancor need not actually form part of the currency scheme. Indeed, it would be advisable to refrain from any restrictions which would make bancor less easily usable than gold. On the other hand, any country wishing to limit its exports should be at liberty to do so without discriminating between those paying in gold, national currency of the exporting country, or in international currency. As we saw earlier in this book, the absence of any planning of import trade would disorganise the planning of national production and consumption. The same is true about the absence of any planning of export trade. If a country is exposed to being depleted of certain goods by unexpectedly heavy purchases from abroad, it might cause

grave dislocation of its own economic life, especially during the early post-war years while supplies are likely to remain short.

17. It is to the interests of British trade that " abnormal war balances " should not be consolidated under any international currency scheme. For, if blocked sterling held by Latin-American countries can only be withdrawn through the purchase of British goods, the existence of this international floating debt should go a long way towards enabling British export trade to recover its Latin-American markets. For this reason, the provision about the consolidation of these balances should be omitted from the currency Plans

18. Regarding the amount of the facilities to be provided under the Currency Plans, the British negotiators should hold out for a figure that is decidedly nearer to the one envisaged under the British Plan than to the very inadequate amount of two and a half milliard dollars envisaged in the American Plan. This would be difficult if the provisions of the American Plan were to be adopted, since it is the United States that would have to supply the largest amount of funds On the other hand, under the Keynes Plan there is no absolute necessity for supplying any funds at all, unless the participating countries decide to do so for the sake of creating a contingency reserve. Moreover, the British quota would be more or less equal to the American quota The British negotiators would thus be in a strong position to argue in favour of large facilities without exposing themselves to the accusation that they were being generous with American money. Admittedly even under the Keynes Plan the United States would make the largest contribution by accepting bancor in payment for her large export surplus. This is, however, not the same as contributing to the Fund in gold or even dollars. The United States would always be in a position to spend the bancor balance just as if it consisted of a holding of gold. On the other hand it would renounce the use of the gold or dollars contributed under the provisions of the American Plan. One of the great advantages of the Keynes Plan is exactly that it provides a formula under which the United States could make a contribution without making any sacrifice. For this reason it is possible to insist on larger total facilities under the Keynes Plan, than under the American Plan. It is essential

that the British negotiators should press their claim for a generous amount. The scheme cannot possibly attain its object of inspiring confidence and of meeting the requirements of the poorer nations unless the amount of the facilities is fixed on a really liberal scale.

19. It would be a mistake to interfere with the expansionary character of the British Plan On the contrary, even the British Plan does not go far enough in providing for the requirements of reasonable expansion. It stipulates that the facilities offered by the Plan are once for all, and no provision is made for a possible all-round increase of the quotas. While the Board has the power to reduce total facilities, it has no power to increase them beyond restoring them to their original level. Possibly the United States Government would object to granting such powers, in which case it would be advisable to accept the American point of view, provided that the amount of facilities is fixed at a reasonably high figure. It would be a mistake, however, to accept the low figure proposed by the American Plan without providing for its substantial increase by a decision of the Board should this become necessary.

20. Adaptability is one of the great advantages of the British Plan over the American Plan. Under the latter it would be almost impossible to pass major decisions, since any country or countries commanding 20 per cent. of the votes would be in a position to veto any decision. When it comes to altering the statutes of the proposed institution, the American Plan contains no provision. The British system of decisions by a simple majority and provisions for changes within the first five years has great advantages over the rigid American system, and the negotiators should not give way in this respect Indeed, there is much to be said in favour of a more precise definition of the circumstances in which changes would be advisable.

21. In no circumstances must the British negotiators accept the American demand providing for the perpetuation of the world's maldistribution of gold that will exist after the war. The international institution should not be given powers to call upon participating countries to surrender their newly acquired gold.

22. The provisions under the British Plan concerning the

granting of credits without security up to the limit of 50 per cent. of the quotas are open to criticism unless a contingency reserve is created on the foundation of the institution. On the other hand, the American Plan goes too far in playing for safety, since if a country borrows more than the paid-up portion of its quota it has to deposit additional securities. A solution between the two extremes can doubtless easily be found.

23. There is much to be said in favour of extending the sphere of activities of the proposed institution by authorising it to transact various kinds of banking business Most of the types of transactions envisaged in the American Plan are not necessitated by the objects which the institution proposes to attain. Nevertheless, it is advisable to err on the safe side and authorise the institution to transact any type of business which might conceivably help it in its functions. In this respect the American Plan follows the course usually taken by financiers registering a new company. They usually include among the kinds of business which the new company proposes to do various transactions not envisaged in the beginning at any rate, in order to save the trouble and expense of subsequent amendments. In this respect and in many other respects the American Plan is more businesslike than the British, and since this appeals to the businesslike American mind, there is everything to be said in favour of following the American method.

24. While there is a very strong case for incorporating businesslike details into the Plan, it would be a great pity if this were done at the cost of the width of its conception. It is possible to be imaginative as well as businesslike. In making concessions in various directions the British negotiators should take care not to sacrifice the fundamental innovations incorporated in the Keynes Plan. They should insist that instead of patching up the existing system a new system should be adopted.

From all the above observations it would appear that a compromise safeguarding the vital interests of both the United States and Great Britain is within the realism of practical possibility. Whether in practice a compromise will be reached is, of course, another question. There is no economic reason why the two Treasuries should not come to terms, but whether they will do so or not will largely depend on political considerations. The attitude taken up by the United States Treasury is that there can be no substantial modification of the White Plan because any concession is likely to be rejected by Congress. In other words, the most Great Britain and the other Allied Governments can hope for is to obtain some modifications of detail without altering the basic principles on which the American scheme rests. As a matter of fact, even the American Plan is subject to violent attacks in the United States, and there is a widespread feeling that it has gone far beyond the limit to which American public opinion is prepared to go. It is opposed by banking interests in New York, who feel that there is no need for such drastic change and that the dollar should simply be accepted as the international currency It is opposed by the Isolationists, who want the United States to retire into her shell after this war as she did after the last war. It is opposed by the enemies of President Roosevelt—their name is legion—who seize every opportunity to wreck every scheme supported by him. It is opposed by anti-British opinion in the United States, inspired by the eternal suspicion that in any international arrangement Britain is likely to " pull a fast one " over the United States

The only active support an international currency Plan can expect is from a small minority of internationally-minded Americans, and from exporting interest which must realise that it is impossible to expect the world to import American goods unless the means are provided to enable foreign countries to pay for them Indeed, the only hope the Keynes Plan stands of being accepted in substance by the United States lies in the possibility of powerful American exporting interests realising that under it they would stand a better chance than under the White Plan. One of the fundamental characteristics of the American people is their irresistible desire to sell, sell and sell. It is the dream of the American exporter that every one of the 400 million Chinese should own a Ford car, and that all the male inhabitants of the globe should shave with American-made electric razors. If under the British Plan this dream can be brought nearer to reality than under the American Plan, then American producers and business men will do their best to induce their Government to accept the British formula—that is if they realise where their interests lie. Unfortunately, the average American exporter is oblivious of the broader implications of his problem. All he wants is to be paid in dollars, and he neither knows nor cares where the dollars are to come from.

It seems certain that the balance of influence in the United States will work against the acceptance of the Keynes Plan, or even of a compromise in which some of the essential features of the Keynes Plan are retained The chances are that a Plan which is approved by American opinion would have to be very similar to the White Plan. It would hardly deserve the name of a compromise as it would only depart in minor details from the original American suggestions

From a British point of view the acceptance of a Plan which would be acceptable also to the sections of American opinion opposed to the Keynes Plan would be detrimental to vital and legitimate national interests. It is certainly not worth while for this country to renounce the elasticity of sterling, to submit to American control through the allocation of voting rights in accordance with the American formula, to give up the Sterling Bloc or to renounce the advantages of bilateralism, for the sake of a solution substantially on the lines of the White Plan. Above all, it is not worth while for Great Britain to give up the immense adventages of economic planning by agreeing to unplanned free trade and to free exchanges This latter point will be examined in detail in the following chapter.

CHAPTER XV

EXCHANGE CONTROL AFTER THE WAR

If I were asked which single decision in the economic sphere is likely to affect the economic welfare of this country and of mankind to the highest degree, I would answer unhesitatingly that it is the decision whether or not to maintain exchange restrictions. From the point of view of the immediate future of mankind, it will make all the difference between orderly reconstruction and wild chaos From the point of view of the more distant future, it will make all the difference between planned prosperity and unplanned poverty. It will make all the difference between monetary expansion and the return to the cult of scarcity It will determine whether prices will be stable or whether they will fluctuate wildly, causing industrial, social and political disorder. If the choice lies between the Keynes Plan without exchange control and exchange control without the Keynes Plan, the latter should be chosen without hesitation, apart from other reasons, because the Keynes Plan without exchange control is doomed to break down within a very short time.

The attitude of the authors of both the Keynes Plan and the White Plan towards exchange control is rather contradictory. It is characteristic of the atmosphere of cross-currents in which both plans have been conceived that no clear-cut line is indicated in either plan on this vitally important issue.

The Keynes Plan is evidently in favour of retaining exchange control This is indicated by the following passage on page 14 of the Report —" Many Central Banks have found great advantage in centralising with themselves or with an Exchange Control the supply and demand of all foreign exchange, thus dispensing with an outside exchange market, though continuing to accommodate individuals through the existing banks and not directly. The further extension of such arrangements would be consonant with the general purposes of the Clearing Union, inasmuch as they would promote order and discipline in international exchange transactions in detail as well as in general. The same is true of the control of capital movements . . . which many states are likely to wish to impose on their own nationals" Again, on page 16, the Keynes Plan remarks: "There is no country which can, in future, safely allow the flight of funds for political reasons or to evade domestic taxation or in anticipation of the owner turning refugee Equally, there is no country that can safely receive fugitive funds, which constitute an unwanted import of capital, yet cannot safely be used for fixed investment. For these reasons it is widely held that control of capital movements, both inward and outward, should be a permanent feature of the post-war system It is an objection to this that control, if it is to be effective, probably requires the machinery of exchange control for *all* transactions, even though a general permission is given to all remittances in respect of current trade. Thus, those countries which have for the time being no reason to fear, and may indeed welcome, outward capital movements, may be reluctant to impose this machinery, even though a general permission for capital, as well as current, transactions reduces it to being no more than a machinery of record. On the other hand, such control will be more difficult to work by unilateral action on the part of those countries which cannot afford to dispense with it, especially in the absence of a postal censorship, if movements of capital cannot be controlled *at both ends* It would, therefore, be of great advantage if the United States, as well as other members of the Clearing Union, would adopt machinery similar to that which the British Exchange Control has now gone a long way towards perfecting."

At the same time, the Report allows for the attitude of the United States, which is decidedly against exchange control. Hence the observation that the structure of the proposed Clearing Union does not require such measures of centralisation or of control as have been adopted by Great Britain. "It is, for example, consistent alike with the type of exchange control now established in the United Kingdom, or with the system now operating in the United States The Union does not prevent private holdings of foreign currency or private dealings in exchange or international capital movements, if these have been approved or allowed by the member States concerned." On page 16 the Report remarks that "The universal establishment of a control of capital movements cannot be regarded as essential to the operation of the Clearing Union; and the method and degree of such control should, therefore, be left to the decision of each member State. Some less drastic way might be found by which countries, not themselves controlling outward capital movements, can deter inward movements not approved by the countries from which they originate."

This concession to the American point of view is in itself perfectly reasonable. Where the Report is open to criticism is that it does not know its own mind, whether it really wants control or not. On page 17 it declares that it should be laid down that members of the Union would not allow or suffer among themselves any restrictions on the disposal of receipts arising out of current trade or "invisible" income This is in direct contradiction to the preference for the maintenance of the existing British exchange control expressed on page 16.

The American Plan is also guilty of inconsistency on the subject of exchange control. Article 2 of Chapter VI declares that participating countries are to undertake "To abandon, as soon as the member country decides that conditions permit, all restrictions and controls over foreign exchange transactions (other than those involving capital transfers) with other member countries, and not to impose any additional restrictions without the approval of the Fund The Fund may make representations to member countries that conditions are favourable for the abandonment of restrictions and controls over foreign exchange transactions, and each member country shall give consideration to such representations." This clause implies that the United States Treasury is not absolutely opposed to maintaining restrictions on capital transfers Indeed, Article 3 provides for measures of co-operation to render effective any such control. On the other hand, Chapter 1 of the Report declares that one of the purposes of the Fund is "To reduce the use of foreign exchange controls that interfere with world trade and the international flow of productive capital." It appears that while the

British Plan is definitely in favour of maintaining control on capital transfers, the American Plan is hesitating and self-contradictory on this point, and while the American Plan is definitely in favour of abolishing restrictions on foreign exchange transactions arising from current trade, the British Plan is hesitant and inconsistent in this respect

This difference of attitude is quite understandable The United States, being in possession of the bulk of the world's monetary gold supply, does not consider it necessary to take any measures safeguarding itself against withdrawals of capital. She can well afford to pay out in gold any foreign holders of dollars wanting to withdraw their funds. On the other hand, Great Britain, having used up her gold reserve and most of her easily realisable foreign assets, would be at the mercy of foreign holders of sterling unless the restrictions which are operating at present are fully maintained The reason why restrictions on capital transfers alone are not considered sufficient is, of course, that if commercial exchange transactions are free they can easily be abused for effecting capital transfers. This is duly realised by the Keynes Plan; hence, the observation that control over commercial transactions will be necessary even if it only amounted to a machinery of record, enabling the authorities to make sure that the commercial transactions are genuine

Anyone who is capable of envisaging the possibility of operating the Keynes Plan or the White Plan without a watertight control over capital movements must be lacking in an elementary sense of reality For there can be no doubt that after the war the world will witness sweeping movements of funds unless they are prevented by efficient control It is true some of the movements will be in the right direction There will be a certain amount of repatriation of funds by returning refugees The chances are, however, that most wealthy refugees will stay away from Europe and that in the course of time they will be joined by many others who having preserved their fortunes during the German domination, would not want to take another chance and would transfer their capital and their residence to safer countries while the going is good If the transfer of capital is left free--or, what amounts to almost the same thing, if restrictions are not enforced effectively enough—fear of further

European wars would result in a sweeping flow of funds to the Western Hemisphere. In particular, if, as is to be feared, Germany is treated too leniently, then many people in liberated countries, knowing as they do their Germans from close contact, will anticipate an early renewal of Germany's bid for world power, and will seek safety for themselves and their fortunes.

Nor is this all by a long way There are many other factors making for abnormal movements of funds, perhaps on an even larger scale than before the war There is bound to be a certain amount of internal political instability in some countries after the war, giving cause for flights of capital. It seems certain that in many European countries the first general election after their liberation will bring in a left-wing Government, and this will produce the usual effect, giving rise to fears of anti-capitalist measures.

Many people are in favour of returning to free foreign exchange dealing on the ground that this would provide a safeguard against a Socialist Government. The mere possibility of such a Government would lead to a flight of capital, and the fear of a depreciation of the national currency would induce the majority of the electorate to vote Conservative, as it did in 1931 in Great Britain. It may well be asked, however, whether the return to conditions in which the foreign exchange market unduly influences elections, and the realisation of this fact would not endanger democracy. If a free foreign exchange market is regarded by wealthy people as their ultimate safeguard against what they regard as a "bad" Government, they ought to bear in mind that elections which express the true intentions of the electorate, and are free of the influence of artificial financial crises, are the ultimate safeguards against revolutions.

A favourite argument of the supporters of free exchange dealings is that, since the instability of exchanges is but a symptom indicating political instability, it would be foolish to try to suppress the symptom by exchange restrictions, instead of dealing with the underlying cause of the trouble. Instead of stopping capital movements, let us stop wars and fear of wars, revolutions, social unrest, and so on What an excellent idea! We are all in favour of all that and also of fair weather, good health and everlasting happiness for all. A thousand pities that political stability cannot be achieved by simply deciding that it would be a much better solution than exchange control. Indeed, as we shall see below so far from being an alternative solution to political stability, absence of exchange control is in itself apt to cause political instability where there would be none if exchanges were adequately controlled

In any case, political factors will not be alone in causing major capital movements after the war There is every likelihood of a sweeping Wall Street boom, which would attract vast funds from impoverished Europe. Wide fluctuation in American national income and importing capacity through booms and slumps will also make for the instability of the exchanges. Differences in the degree and method of taxation are also likely to drive substantial amounts of capital from highly taxed countries.

What are the defences which Europe can put up in face of all these factors making for disturbing capital movements? Between the two wars, most European countries—at any rate, the wealthier amongst them—had substantial gold reserves and foreign assets. Most of these reserves have now been more or less exhausted. Great Britain would not be able to stand a fraction of the capital movements she stood between 1931 and 1939 Nor would the facilities granted under the American currency plan go a very long way towards enabling otherwise weak countries to resist pressure due to flight of capital Even the very generously reckoned facilities under the Keynes Plan would come to an early end if there were a real landslide such as a flight of national capital before a general election or as a result of a war scare.

Once the reserves and the facilities under international currency plans are exhausted—and the fact that these resources are limited would inspire distrust and would hasten their exhaustion through a flight of capital—the Governments concerned would have the choice between two evils: they may let the exchange rate go, or they may try to defend it with the aid of orthodox deflationary methods. If they allow the exchange rate to depreciate and fluctuate, this would tend to a disorganisation of the price structure, rising cost of living, wages disputes and social and political unrest. The experience of France between 1936 and 1938, when the franc was allowed to become the play-thing of speculators, is characteristic in this respect. The alternative is to resort to high interest rates, and deflationary credit restrictions, leading to wholesale unemployment, slump in prices and prolonged depression with grave political consequences. The working classes are not likely to put up once more with perennial unemployment due to the mismanagement of monetary policy. In the interest of avoiding unrest that might lead to revolutionary upheaval, it is advisable to maintain exchange restrictions, or at any rate to restore them whenever there is indication of an outflow of capital. Since it takes time before the outflow is realised and before restrictions are adopted and made effective, this last-named solution would largely amount to closing the stable door after the horse has gone.

Many people who are aware of the necessity for control over capital movements, at least during the "reconstruction period," argue in favour of restoring the freedom of foreign exchange transactions arising from current foreign trade. They are inclined to exaggerate the adverse effect of exchange restrictions on trade. During the war, foreign trade is hampered, not by exchange control, but by entirely different causes, such as lack of supplies and of transport facilities, or lack of foreign exchange, which latter would be even more pronounced but for the exchange restrictions It is sheer nonsense to suggest that British exporters are unable to export because instead of selling the foreign exchange proceeds of their goods in the open market they have to offer them to the Treasury—incidentally, through the intermediary of the same banks who would handle the sale of the exchanges in the open market. Nor is it reasonable to suggest that importers are handicapped by the necessity of filling in forms. Of course, it is somewhat irritating to have to comply with official regulations of any kind, and if the choice rested with the merchants they would naturally prefer not to have to fill in forms. Those who are inclined to exaggerate the inconvenience of the control ought to be reminded, however, that in the absence of restrictions the foreign exchanges available for importers would be used up by those transferring capital abroad, and that exporters would not exactly benefit either by unstable exchanges or by high interest rates that would arise in the absence of exchange control.

In any case, it is idle to suggest that exchange control should be confined to capital transactions. For the latter cannot possibly be controlled effectively without at least a formal control of trade transactions, to ascertain whether they are genuine. As we saw above, the Keynes Plan duly realises this On the other hand, there is nothing to show that the authors of the American plan take this fact into account. Yet the British experience during the first year of the war clearly shows that if exporters are allowed to sell the proceeds of their exports in the free market, much of it will not be bought by importers but by those wanting to transfer capital abroad In such circumstances, to rule, as the Keynes Plan does, that it should be forbidden to participants in the scheme to place any restrictions on the disposal of receipts arising from trade would preclude efficient exchange control. It would open innumerable loop-holes for the evasion of restrictions on capital transfer

One of the favourite arguments against exchange restrictions after the war is that they would necessitate the maintenance of postal censorship in time of peace. Owing to the unpopularity of such censorship, this argument carries some weight before the public. While people willingly submit to postal censorship (amongst many other kinds of temporary curtailment of freedom) for the duration, they would not be enthusiastic about any arrangement which would mean the prolongation of postal censorship after the war.

Anxious to ensure that the maintenance of exchange restrictions should not meet with unduly fierce opposition, the Government is now inclined to take the line that control of capital transactions would not necessarily involve the continuation of mail censorship. This was stated by Lord Keynes in his speech during the debate on post-war currency in the House of Lords on May 18th, 1943 After emphasising the need for continuing the control of international capital movements after the war, he declared "Those who are experienced in these matters advise that adequate control of capital movements should be possible without a postal censorship I mention this in order to relieve a natural anxiety Few of your Lordships I expect, would stand for so gross an infringement of personal rights as a postal censorship in times of peace"

He did not specify how "those who are experienced in these matters" expect to enforce exchange control without postal censorship, or even to whom he was referring. To the best of my recollection, whenever reasonably stringent exchange control has been adopted it has always been accompanied by postal censorship. This was certainly the case in this country and other countries during the last war and this war, and also in Germany and the countries which sought to apply watertight restrictions between the two wars

Those concerned with exchange control in this country are certainly not qualified to be described as having had experience in performing that impossible task. Their work has been facilitated by the existence of censorship ever since full control has been in operation. They could tell us that in at least nine cases out of ten offenders against exchange control have been caught by the authorities through the interception of their correspondence with overseas bankers or with someone else concerned with the transfer or safe keeping of the money that had evaded the control But for the postal censorship, the great majority of offenders would have escaped punishment. What is much more important, their undeclared foreign assets would have never reached the Treasury. Above all, the absence of any fear of being caught through the vigilance of postal censorship would have encouraged many other people to break the law.

Yet another argument of the opponents of exchange restrictions is that they would preclude the provision of facilities for merchants to cover exchange risk arising from foreign trade This argument is singularly ill-informed. Anyone connected with foreign banking or foreign trade knows that the authorities have provided forward exchange facilities during the war, to take the place of the free forward exchange market. Fixed rates are quoted for the principal forward exchanges. Admittedly, these facilities are not perfect Cheaper rates might have been fixed, in view of the absence of exchange fluctuations during the war. Moreover, it is not easy to obtain quotations for forward exchanges which are not quoted officially. These shortcomings could easily be remedied. As far as the official facilities go they compare very favourably with the facilities obtainable before the war in the free foreign exchange market. Under control merchants are not exposed to having to pay prohibitive charges for cover precisely on occasions when it becomes all-important that exchange risk should be covered Under the regime of free exchange, from time to time speculative operations drive the forward discount or premium to a fantastic level, and merchants either have to pay this exorbitant price, or run the exchange risk, or refrain from the transaction. The forward rate quoted by the authorities, on the other hand, cannot be affected by speculative pressure.

Official forward quotations have the advantage of circumventing an evasion of international understanding against competitive currency depreciation. It is not generally realised outside those directly concerned that a depreciation of the forward exchange affects foreign trade in the same way as a depreciation of the spot exchange It stimulates exports and hampers imports If a country, having agreed not to devalue its currency, wants to produce nevertheless the effects of a currency depreciation, all it has to do is to cause a depreciation of its forward exchange Under control this would be, of course, impossible, for forward rates would also be controlled

None of the arguments put forward by the opponents of exchange control carries any weight But, in any case, even a most formidable array of valid arguments would be outweighed by the consideration that the absence of exchange control would rule out the adoption of a policy of planned expansionism, without which it would be impossible to achieve freedom from want Moreover, reconstruction would be gravely handicapped by irregular capital movements

There remains the question whether, in order to ensure the efficient working of the currency plans, it would be necessary to adopt the technical forms of exchange clearing Under the American scheme the question does not arise The idea is that foreign exchange would be transacted in free markets, and that the Stabilisation Fund would enable the Governments to support their respective exchanges by granting facilities in foreign exchanges for which there is a strong demand The trouble is that the strength of the demand cannot be gauged, and it is impossible to ascertain whether it is due to commercial causes, speculation, or transfer of capital Exchange control has the advantage of enabling the authorities to form an idea how they stand. Even under the Keynes Plan, which envisages the maintenance of the existing British system of exchange control, the monetary authorities would not be able to form a clear picture of the position. For, to take an example, this country's requirements of Czech crowns depends not only on the amount of crowns British importers wish to buy and the amount sold to the Treasury by British exporters, but also on the amount of sterling bought and sold by the Czech Treasury from and to its own nationals. If the Bank of England has a surplus in crowns while the Czechoslovak National Bank has a surplus in sterling, then the two items can be cleared against one another, and it is only the net difference that may have to be settled through the Clearing Union. But to be able to know how the authorities stand at any given moment in any particular currency, it would be necessary to run bilateral clearing accounts purely for purposes of accountancy. This would, of course, be impossible in relation to countries with a free foreign exchange market. Countries with restrictions would be uncertain of their position regarding the exchanges of countries with free market This makes it somewhat difficult to work the system. While the clause under which the Keynes Plan declares it optional whether to have exchange restriction may have been a necessary compromise, it was decidedly a necessary evil. It is only under universally adopted restrictions that any international currency plan could be worked truly scientifically. There is no hope, however, for inducing the United States to agree to restrictions—at any rate, not until a major crisis will make American opinion realise that even a rich country stands to gain by safeguarding itself against a flight of capital. This was already realised in 1933, but human memory is short The chances are, however, that before many years the experience of 1933 will repeat itself on an even more sweeping scale. Then, and only then, will the United States realise that even she cannot afford to keep aloof from the world trend towards planned currency.

CHAPTER XVI

ALTERNATIVES TO AN INTERNATIONAL CURRENCY AGREEMENT

We saw in Chapter XIV that the chances of a compromise between the British and American currency schemes appear to be none too bright. It is necessary, therefore, to envisage the possibilty of a failure to come to an agreement

Facing the possibility of a failure, many people seek to serve the cause of an international currency system by painting with the gloomiest possible colours the consequences of a breakdown of this attempt. They make our flesh creep by describing the horrors that await mankind unless one or other of the plans is accepted. Being thoroughly internationalist, many of them do not particularly mind which plan is accepted, so long as there is a British-American understanding on *a* currency Plan, it being taken for granted that whatever is acceptable for Great Britain and the United States will be accepted by the rest of the United Nations They warn the world that lack of such a plan would mean a depreciation race leading to currency chaos; that foreign trade would shrink to a negligible figure and would never be able to recover from its low level, that reconstruction would be gravely handicapped; that there would be abject poverty with no hope of improvement; and that a revival of ruthless trade wars would prepare the way for the third world war within the lifetime of this generation, leading to a world revolution and the collapse of civilisation.

All this is, of course, utter nonsense. There is no reason why the breakdown of the efforts at a compromise should lead to a currency chaos, or to a deadlock in foreign trade. Since the plans do not cover deliveries for reconstruction (which would be arranged under Lend-Lease, relief shipments or through international loans) this breakdown need not affect them. The degree of poverty after the war, and the speed of recovery from it, will depend on the degree of planning and economic discipline accepted by the various nations, more than on anything else. Finally, the idea that a currency system under which multilateral free trade would flourish would remove the likelihood of war, while a revival of bilateralism would lead to a third world war is entirely erroneous Rabid free traders are in the habit of denouncing the Ottawa agreement and the various bilateral trade agreements as the cause of this war, as a convenient argument in support of their thesis. In reality, free trade is more likely to lead to war than autarky and bilateralism. Under free trade a country has to submit helplessly to being driven out of its foreign markets and even out of its home market. If it is unable or unwilling to lower its standard of living to compete successfully with its rivals working at a lower cost, then the only way in which it can defend its prosperity is by making war on its trade rival. On the other hand, under autarky a country is always in a position to safeguard at least its home market by peaceful means; and through bilateralism it is in a position to preserve its vital foreign markets by insisting that its customers should buy its goods. This does not necessarily mean that autarky and bilateralism are to be preferred to multilateral trade. But it does mean that the argument that a breakdown of the present attempt at commercial and financial internationalism would lead to war and a collapse of civilisation is grossly exaggerated

Possibly it may be good diplomacy to pretend to believe that a failure of this attempt would mean the end of every hope for mankind. Although it would not deceive the negotiators of the Treasuries, it might conceivably influence a section of public opinion in favour of pressing the Governments to reach a compromise The extent of this pressure is not likely to be very strong, for most of those intelligent enough to take an active interest in the currency Plans are also intelligent enough to see through the ruse.

Instead of breaking into hysterics at the very thought of a failure, let us try to examine dispassionately its possible consequences Some opponents of the Plans, who would welcome the breakdown of the attempt, hope that in the absence of a new currency system the world would sooner or later return to the orthodox system of the gold standard. In that they are hopelessly wrong, however. The chances are that, so far from returning to free exchange dealings, most countries would retain war-time restrictions. Indeed, while under the American Plan, and even under the British Plan, restrictions would be relaxed by many countries, in the absence of a plan they might be maintained in full.

The chances are that in the absence of an international agreement the world would become divided into currency blocs, the most important of which would be the sterling area and the dollar area. It is conceivable that international currency Plans would be adopted within these currency blocs. There is no reason why the Keynes Plan should not be applied in the sterling area, and the White Plan in the dollar area. Some countries belong definitely in one or the other group, but a number of countries would have to take their choice. Europe, for instance, belongs geographically and economically to the Sterling Bloc rather than the dollar bloc; but since most relief shipments and long-term loans must necessarily come from the United States after the war, these countries would be tempted to join the Dollar Bloc for fear that they might not otherwise receive assistance from the United States. On the other hand, some Latin-American countries, especially the Argentine, would be drawn by their permanent economic interests into the Sterling Bloc.

It has been suggested in some quarters that in the absence of a new international institution at the time of the cessation of hostilities the Bank for International Settlements should be made use of for financing reconstruction It seems inconceivable, however, that any decent Government would wish to make use of an institution with such a record of pro-German appeasement and political intrigues as that of the B.I S It would be idle to deny that in the absence of an understanding about an international plan, there would be a danger of a resurrection of the moribund B I.S There would be no justification for it from a technical point of view, for there is nothing the B I S. could do by way of financing relief and reconstruction that could not be done by other existing banks. Politically it would be a mistake to place power in the hands of the B I.S , even after the removal of its Axis directors, two of whom—Kurt Freihern von Schroeder (the man who brought in Hitler) and Walter Funk (the organiser of the scientific looting of Europe by means of currency conjuring) are likely to be included in the list of war criminals. However, it may present some immediate convenience to use a bank with an organisation experienced in inter-Governmental transactions, and it is to be feared that this consideration will prevail in spite of the opposition that the revival of the B.I S would arouse.

From the all-important point of view of the chances of planning in Great Britain and Europe the failure to link up with the United States and to create a system making for free trade might well prove to be a blessing in disguise. It seems more than probable that the United States will revert to rugged individualism and unfettered competition after the war. She is one of the very few countries rich enough to be able to afford that wasteful system. For impoverished Europe it is of vital importance to attain the maximum of efficiency in the interests of reconstruction and of the restoration of wealth destroyed by the war. Europe could ill afford not to make full use of her resources and productive capacity This can only be done by abandoning the system of *laissez faire* in favour of a planned economy Now the closer the links with ultra-individualist United States the stronger will be the inducement to emulate her in her individualism. In theory, there is no need for the participants in either currency scheme to adopt a uniform economic policy. In practice, the United States, with her superior economic power and political influence, would be able to impress on the weaker States the necessity of following in her footsteps.

Moreover, as we saw in earlier chapters, there is a danger that the adoption of either currency plan might lead to the development of unplanned free trade, which would make the planning of the internal economies of the countries concerned almost impossible Finally, if the adoption of the currency schemes should lead to a relaxation or removal of exchange restrictions —under the American plan this would be a certainty—it would rule out all hopes of planned expansionism.

As far as Great Britain is concerned her only hope for remaining a first-class economic Power lies in planning If she tried to hold her own against the United States under a competitive individualist system she would become dependent for her very existence on American help. For to play the individualist game requires liquid financial resources, and the only source from which they are obtainable on a large scale is the United States. Assistance would be forthcoming—at a price. On the other hand, if this country departs from the old system, she stands every chance of holding her own. After all, the natural resources of the British Empire—even without counting the Dominions or India—are at least as large as those of the United States. Great Britain has the manpower, technical skill and organising capacity to exploit these resources. If this is done according to a plan and not in a haphazard way, and if the war-time principle that productive capacity must be used in full and finance must be provided for it, is applied in time of peace, then Great Britain's depleted resources will soon become replenished, and the standard of living can be raised well above pre-war level, at the same time as recovering a first-rate international economic position. On the other hand, if Great Britain tried to play the game according to the orthodox rules, then her Government would have to go, cap in hand, to Washington every three months or six months for additional help And that would prelude really friendly British-American relations based on mutual respects

Beyond doubt in many ways it would be easier to plan in the absence of multilateral free trade. That is, multilateralism would be useful provided that it is not done on the principle of *laissez faire*. As far as possible trade should be planned under international agreements regarding all essential commodities, but there may be no harm in allowing luxuries to drift into the country—within limits—through multilateral free trade. But to leave foreign trade at the mercy of incalculable tendencies under the multilateral system would rule out the possibility of scientific planning.

If the attempt at an international solution on the lines of the Keynes and White Plans should break down, this would not necessarily mean the end of collaboration with the United States. Indeed, the United States would be very anxious to safeguard itself against competitive currency depreciation, and since some countries may be unable to maintain their exchanges in the absence of an adequate gold reserve, this consideration may lead to a policy of lending to replenish the reserves of financially weak countries. Possibly this lending may assume the form of day-to-day support to bolster up weak exchanges, or of credits granted for definite purposes, instead of a participation in an international arrangement as proposed by the Keynes and White Plans. Indeed, a considerable section of American opinion would prefer some such arrangement under which the United States would retain direct control over the resources she is prepared to lend, instead of placing them at the disposal of an international Board.

Some agreement on the lines of the Tripartite Currency Agreement may also be sought by the United States. This would provide ample scope for negotiating understandings on a sound basis of give-and-take, but in a conciliatory spirit. It would be a mistake to imagine that in the absence of an international Plan under which Great Britain would relinquish her right to devalue she would embark on a ruthless depreciation race with the United States Friendly relations between the two countries are of vital importance, and American opinion is not likely to be lightly antagonised by a devaluation of sterling, unless conditions are such that even the resentment of the United States would be a lesser evil than the defence of sterling at a grossly overvalued level The mere fact that Great Britain's hands are free might induce American opinion to show more understanding towards her difficulties. If the United States Government has the right to veto a devalution of sterling, the pressure by American business interests to induce it to abuse that right might be irresistable. If, on the other hand, both partners are free, there would be a good chance of collaboration as between equals.

Evidently, even in the case of the failure of the attempt to reconcile the Keynes Plan and the White Plan the world would manage to carry on somehow Indeed, as we have seen above, there would be certain compensating advantages. While in the case of the Keynes Plan they would not make up for the loss of benefits that would be derived from its application, in the case of the White Plan most countries—Great Britain among them—would be decidedly better off without its adoption. It is not correct to suggest, as it is sometimes suggested, that even the White Plan is better than no plan at all. Viewed from the narrow point of view of immediate American interests, that may perhaps be so. But taking a long and general view, the progress of mankind would be better served without any international currency Plan than with the White Plan in its present form. Perhaps, after all, economic and financial conditions are too diverse to allow for the application of a universal plan instead of regional plans—unless the United States agrees to adapt her point of view to a sufficient extent to meet halfway the point of view of less fortunately placed countries Otherwise Great Britain and other countries in a similar position are well advised to work out their salvation in their own way. It is a great mistake to live beyond one's means in order to be able to keep up with wealthier friends While the United States can afford the luxury of an orthodox monetary system, any country with inferior liquid financial resources can only try to follow her lead at a grave disadvantage to itself. Unless an intermediate solution can be found which, without being ideal either for creditors or for debtors, is acceptable for both, the best course is to agree to disagree and postpone the idea of a world-wide currency plan for better days. The chances are that, given a period of peace, Great Britain, the Sterling Bloc and Europe would be able to regain their prosperity in the course of time with the aid of economic planning and an expansionary monetary policy. At the same time, the fruits of the return to an orthodox policy in the United States might well be a recurrence of the costly experiences of 1929 and 1933. As a result, she might eventually become more receptive to modern ideas. Owing to this, and to the readjustment of the balance of economic power, it would then became possible to repeat the attempt to reach an international currency agreement with a better chance of success.

POSTCRIPT.

THE foregoing chapters were written immediately after the publication of the Keynes and White Plans. Owing to war-time conditions the publication of the book has been delayed, and it has become necessary, therefore, to bring up to date the account of the efforts to create a new international currency system for after the war. Negotiations between the Allied Governments to reach an agreement on a system acceptable to all have been proceeding during the second half of 1943. The discussions between H.M Treasury and the continental Allies were suspended soon after the publication of the Plans in April 1943 All Allied Governments sent representatives to Washington to conduct informal discussions with the U.S. Treasury during May and June. In August a strong British delegation, including Lord Keynes and a number of other leading experts, left for Washington and remained there until the late autumn After their return to London negotiations continued through the representative of the British Treasury in Washington and the representative of the United States Treasury in London.

Under the influence of adverse criticism in American political and banking circles immediately after the publication of the White Plan, the United States Treasury decided to modify this Plan in a sense unfavourable from a British and European point of view At the end of August Mr. Morgenthau made public the revised draft, which aroused much criticism in the British Press. While in the original White Plan the initial contributions in gold were fixed at 12½ per cent. of the quotas (in some cases even less) the revised Plan raised them to 50 per cent. What is even more important, the revised Plan stipulated that the deficit countries should pay in gold 50 per cent of the purchase price of the foreign exchanges bought from the Stabilisation Fund

The absurdity of these proposals is abvious. If accepted it would mean that most countries would have to contribute in gold to the Stabilisation Fund more than they are likely to receive in foreign exchange. Let us suppose for the sake of argument that Great Britain's quota was fixed at $400,000,000. This would mean that the Treasury would have to contribute to begin with $200,000,000 in gold. Should the authorities require, say, $300, 000,000 to pay for an import surplus they would have to find another $150,000,000 in gold to pay 50 per cent. of the purchase price. On balance Great Britain would part with $350,000,000 in gold in order to receive foreign exchange of $300,000,000. She would have to exhaust her full quota in order to receive back as much as she contributed In other words, she is expected to make sacrifices in return for the privilege of buying back her own money, or part of it.

This Plan was handed over to the Allied delegates on their arrival in Washington at the beginning of May 1943 By the time they departed at the end of June the United States Treasury had made several concessions as a result of which a third draft was produced. This, while more unfavourable than the original draft was decidedly less unfavourable than the second draft. In the third draft the gold contribution of the participating countries was reduced to well below 50 per cent for all but the wealthiest among them. In other respects too, some of the drastic provisions of the second draft were made more elastic and adaptable.

No authentic information was published about any subsequent modifications of the White Plan during the course of the negotiations with the British experts. An effort was made to come to a British-American understanding in order to be able to present the Allies with a joint Plan. From time to time reports appeared about the trend of negotiations, and while many of these reports were unreliable and contradictory it is nevertheless possible to form a general idea about the trend of the negotiations. It seems that the American negotiators, while willing to incorporate in the White Plan some of the lesser features of the Keynes Plan, refused to consider the adoption of the Bancor system under which the proposed international institution would create credit. Their attitude rules out the possibility of the international currency system becoming of an expansionary character. At the same time the American negotiators are understood to have yielded to a considerable extent to the British demand for a higher degree of elasticity of the exchange rates. Suggestions that the range within which the participating Governments would be entitled to change their parities during the initial period are said to have been discussed, but no information is available at the time of writing as to whether any understanding has been reached on this vital point.

While negotiations about the Stabilisation Fund scheme were proceeding, another American plan for the creation of a United Nations Reconstruction Bank became public. It was also the work of Mr. White and was submitted to the Allied Governments simultaneously with the post-war Currency Plan, in April 1943. The objectives of the proposed Bank, to quote the terms of the explanatory Memorandum, are: "To provide capital for the economic reconstruction of the United Nations; facilitate a rapid and smooth transition from a war-time economy to a peace-time economy in the United Nations; supply short-term capital for the financing of trade among the United Nations—where such capital is not available at reasonable rates from private sources; and help strengthen the monetary and credit structures of the United and Associated Nations by redistributing the world gold supply.

"To eliminate the danger of world-wide crises that are financial in origin, and reduce the likelihood, intensity and duration of world-wide economic depressions; raise the productivity and hence the standard of living, of the peoples of the United Nations.

"To promote a greater degree of economic co-operation and collaboration among the United Nations; make easier the solution of many of the economic and political problems that will confront the peace conference

"To enhance the opportunity throughout the world for a healthy development of democratic institutions, help assure a distribution at fair prices of important scarce raw materials; and promote stability in prices of important commodities.

"Finally, the Bank would provide for the financing and distribution of foodstuffs, clothing and other essential commodities that will be needed in large quantities for the relief of populations devastated by war conditions."

The proposed Bank would possess extensive resources and borrowing powers. The facilities it would be able to grant should go some way towards making up for the anti-expansionary character of the American Currency Plan. In conjunction with the Bank Plan but independently of it, the establishment of two international institutions is proposed, one for the regulation of the international price-level of basic commodities through the creation of buffer-pools, and another for the international planning and control of the development of the production of such commodities.

As far as is known, up to the time of writing, these proposals have not yet been discussed between the Governments. The response to their publication in the United States was if anything even less encouraging than the response to the Stabilisation Fund Plan. Indeed, the published version of the Bank Plan compares unfavourably with the original draft handed over to the Allied Governments six months earlier. The facilities it proposes to grant became materally reduced It seems reasonable to assume therefore, that if Congress ever passed the Plan at all it would have to be whittled down to such extent that it would become a mere shadow of its original shape. For this reason it would be unwise for the Allies to undertake commitments regarding the proposed currency scheme on the assumption that the facilities it is to provide would be supplemented on a generous scale by the proposed Bank Scheme. This appears to have been realised by the Allied Governments, who are believed to have confined their negotiations entirely to the Currency Scheme, leaving the Bank Scheme out of their consideration.

During the last quarter of 1943 there was a distinct stiffening of opposition to the projected international Currency Scheme both in the United States and in Great Britain. The American Bankers' Association came out with a Plan of its own, according to which the international currency should be neither the Unitas nor the Bancor but the dollar; all financial facilities should be granted not through any new international institution but through the well-established channels of the banking system, and only countries which balance their budgets should be entitled to such facilities. Other organisations and individuals, representative of American business interests, pronounced themselves substantially in the same sense. There was some evidence of willingness and even eagerness to grant a large loan to Great Britain, provided that she would be prepared to return to gold and adopt a deflationary budgetary and monetary policy.

In Great Britain bankers were rather reticent to express their views on the currency plans in public. On the other hand, in political circles and in the Press oppositions to linking sterling to the dollar and gold was growing throughout the autumn and winter. Even circles which were originally in favour of some international currency arrangement became increasingly hostile to the idea, especially after it had transpired that most essential features of the Keynes Plan had been dropped. There was a widespread feeling that while the risk attached to committing ourselves to an expansionary international currency system would be a reasonable risk, there could be no justification for any such commitment if the proposed system was of an anti-expansionary character.

Fears were entertained that, notwithstanding the higher degree of elasticity conceded by the American negotiators, in practice sterling might become overvalued owing to a sharp rise in the British price level after the war. The anticipation of such a situation induced the Federation of British Industries to throw its considerable weight into the scales against commitments on such lines, for fear that an overvaluation of sterling might lead to dear money and might handicap export trade. Other Conservative quarters adopted a hostile attitude towards the international Currency Plan owing to the possibility that the American concession in the matter of the elasticity of sterling would have to be paid for dearly by abandoning preference in Empire trade and the protection of domestic agriculture. The Labour Party, too, grew increasingly adverse to currency commitments, in case that they might frustrate post-war efforts to achieve full employment and rule out the possibility of adopting the Beveridge Plan

Even the suggestion that in return for accepting the American point of view on currency, Great Britain would obtain a large gold loan, was received without enthusiasm. It was pointed out that such a loan would merely encourage over-importing and would delay the necessary readjustment of British foreign trade to changed conditions. Or if the proceeds of the American loan should be used for the repayment of blocked sterling balances owned by Latin-American and other countries, this would be equally against the interest of British export trade which would otherwise benefit by the necessity of liquidating these balances through an increased purchases of British goods.

Finally, the remarkably candid statement, contained in a publication issued by the United States Department of Commerce, contributed to no slight degree towards strengthening British opposition to currency commitments. This Report admits that so long as the American national income fluctuates within a wide range as a result of booms and slumps, the capacity of the United States to provide dollars through the absorption of foreign goods must necessarily fluctuate with it For this reason alone, it would be risky for Great Britain or the European countries in general, to establish close financial links with the United States and to adhere to a system which is liable to break down as a result of a sharp contraction of American imports during a period of slump.

Notwithstanding this growing opposition in Great Britain there appears to be, at the time of writing, a strong possibility that a currency agreement may be reached. The British Government is believed to be prepared to go to considerable lengths to come to an agreement for the sake of general good relations and collaboration with the United States. To that end it is willing to make sacrifices, however much they might be disapproved of by experts, business interest and political circles. This attitude ignores the fact that the only possible solid basis for British-American friendship after the war is mutual respect. If in consequence of an unfavourable currency agreement Great Britain is placed in a position in which she is unable to carry on without frequent American assistance, her role will be reduced to that of the poor relation who may inspire compassion but not respect. The only hope for Great Britain to be able to deal with the United States on an equal footing is to work out her own salvation without depending on American financial assistance. To that end it is indispensable that she should have a currency system which would provide her with a maximum of opportunity to make full use of her productive resources. Her financial, economic and political power in the post-war world would be gravely impaired by the choice of a currency system that would rule out planned expansion. No advantage that could possibly be gained directly or indirectly by adherence to such a currency system would be worth such a sacrifice